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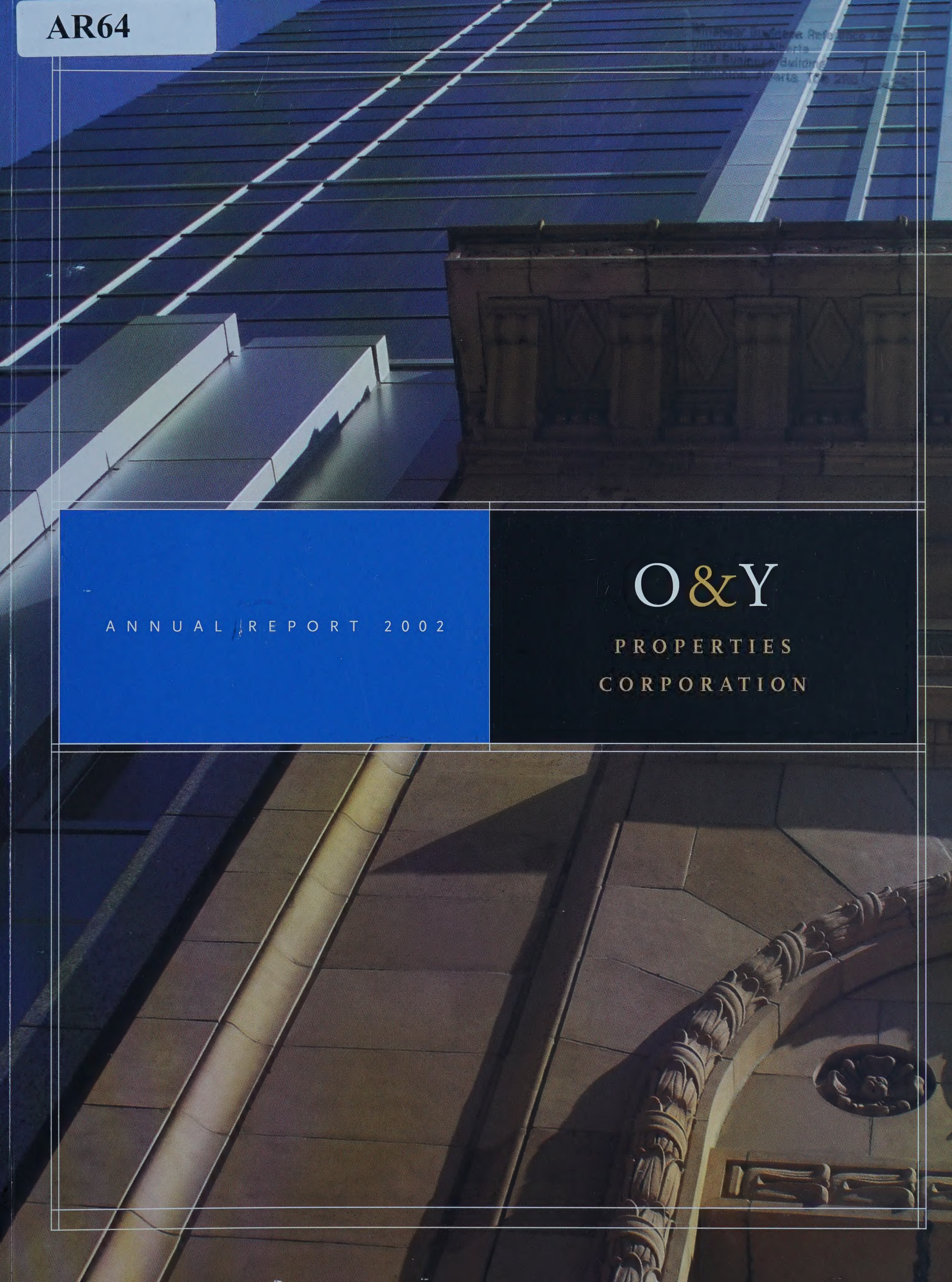


ANNUAL REPORT 2002

# O&Y PROPERTIES CORPORATION

# O&Y PROPERTIES CORPOR

## A Balanced Approach to the Real Estate Business

O&Y Properties Corporation is a publicly traded commercial real estate company focused on the development, ownership and management of high quality office buildings, located primarily in major markets across Canada.

- Owns more than 50 per cent of O&Y REIT
- Owns First Canadian Place, Canada's premier business address
- Develops new office properties, such as the Maritime Life Tower in downtown Toronto
- Owns and operates a national real estate services business through O&Y Enterprise and O&Y CB Richard Ellis Facilities Management, a partnership with CB Richard Ellis

## O&Y REAL ESTATE INVESTMENT TRUST

Is a publicly traded closed-end real estate investment trust that trades on the Toronto Stock Exchange under the symbol OYR.UN

Owns a portfolio of 19 high quality office properties comprising 4.7 million square feet, located mainly in seven major downtown markets across Canada; excellent mix of corporate and government tenants with strong covenants

Holds an economic interest in cash flow and value growth of Canada's leading business address, the 2.7 million square foot First Canadian Place complex in downtown Toronto

Advanced a $40 million mezzanine loan to O&Y Properties Corporation in connection with the construction of the Maritime Life Tower, the first new major office tower in downtown Toronto in nearly a decade, and has an option to purchase the building

# TION AT A GLANCE

## FIRST CANADIAN PLACE

A 2.7 million square foot, Class AAA, 72-storey office and retail complex located at the corner of King and Bay Streets in downtown Toronto, considered to be the premier business address in Canada

## DEVELOPMENT

Recently completed the Maritime Life Tower, the first office building to be developed in downtown Toronto in nearly a decade

Experienced development staff have executed millions of square feet of office projects over the years and developed the most up-to-date tools to assist in project delivery

Future development projects include Place de Ville III in Ottawa

## REAL ESTATE SERVICES

Our real estate services businesses operate offices in seven major centres, employing approximately 1,000 people, servicing a portfolio of more than 74 million square feet

**O&Y Enterprise**

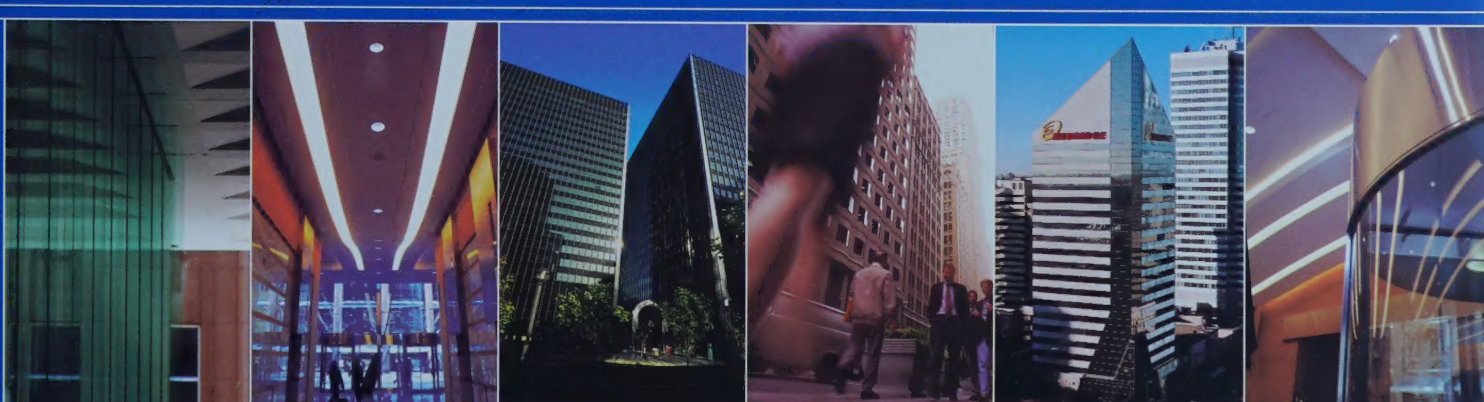
A leading Canadian third-party provider of integrated real estate services

Complete range of services, including leasing and property management

Focused on national clients, large contracts in major markets

**O&Y CB Richard Ellis Facilities Management**

A partnership between O&Y and CB Richard Ellis, providing corporate real estate services, project management and facilities management services across Canada



Given the wide range of choices in today's marketplace, there are a number of reasons that make O&Y Properties Corporation a good investment

**IT OFFERS INVESTORS:**

A Balanced Investment

• • •

A Diversified Portfolio of Assets and Activities

• • •

An Expert and Motivated Management Team

• • •

A Strong Balance Sheet

## SOLID PERFORMANCE IN CHALLENGING TIMES

In 2002, O&Y Properties Corporation delivered solid operating and financial results in the midst of challenging and rapidly changing economic conditions.

**WE RECORDED A NUMBER OF SIGNIFICANT ACCOMPLISHMENTS:**

- Introduced a quarterly dividend equal to $0.20 per share annually;
- Drove the growth of O&Y REIT by completing $66 million of property acquisitions;
- Enhanced cash flow stability through a major long-term lease renewal with the largest tenant at First Canadian Place;
- Completed construction of the Maritime Life Tower on time and below budget; and,
- Added two new major contracts to our corporate real estate services and facilities partnership, O&Y CB Richard Ellis Facilities Management.

# A Disciplined Approach

A COMBINED LETTER FROM OUR CEO AND PRESIDENT

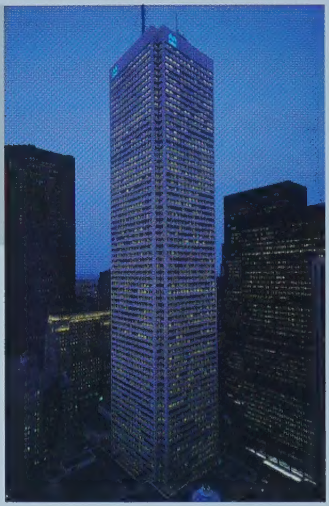
O&Y PROPERTIES CORPORATION (O&Y Properties) began 2002 with high expectations and a sense of determination, but ended it with a degree of lingering uncertainty. As the year progressed, the impact of world events compounded by the collapse of corporate icons, led to the further collapse of confidence in much of the business world. This, of course, had significant implications on confidence in the real estate area of the economy, including the office sector.

Despite this, we delivered solid results and recorded a number of accomplishments. This success was achieved, in part, through acquisition growth in our subsidiary, O&Y REIT, as well as aggressive renewals and re-leasing in all of our properties.

The year began well in our sector, with demand for office space in our markets slow but adequate, and interest in equity markets strong. This allowed O&Y REIT to complete a private placement of limited voting units for proceeds of just over $50 million, announce its first property acquisitions and increase its distributions to investors by 2 cents per limited voting unit annualized. At the same time, O&Y Properties introduced a quarterly dividend to its shareholders of 20 cents per share annualized.

FIRST CANADIAN PLACE, *Toronto*

*Canada's premier business address*



We were cautiously optimistic. However, general business conditions did not turn around as we had expected and office market fundamentals continued to slow. Despite this, we were able to meet most of our objectives for the year.

We renewed or re-leased a substantial portion of the 2002 lease expiries in both O&Y REIT and First Canadian Place, at rates higher than those at expiry. We were able to successfully extend 423,000 square feet of leases in First Canadian Place with the building's largest tenant, BMO Financial Group. We extended its leases that were set to expire between 2003 and 2005, to 2013. This is a very important accomplishment, as it further strengthens the financial stability of First Canadian Place.

*(l)* Philip Reichmann
*Chief Executive Officer*

*(r)* Frank Hauer
*President*

IN TODAY'S WORLD OF RAPID CHANGE, INVESTORS HAVE ACCESS TO A WIDE RANGE OF INVESTMENT OPPORTUNITIES THAT OFFER AN EQUALLY WIDE RANGE OF RETURNS. WE BELIEVE THERE IS A COMPELLING CASE FOR CHOOSING A BALANCED INVESTMENT, SUCH AS O&Y PROPERTIES, WHICH HAS A DIVERSIFIED PORTFOLIO OF ASSETS AND ACTIVITIES, AN EXPERT AND MOTIVATED MANAGEMENT TEAM AND A STRONG BALANCE SHEET.

O&Y REIT acquired four properties, totaling $66 million, bringing the REIT's portfolio to 19 buildings, or 4.7 million square feet of leaseable space.

The four properties acquired during the year were: a 50 per cent interest in the Canadian Western Bank Building and the Enbridge Tower, both in Edmonton, as well as 1035 – 7th Avenue S.W. and the remaining 50 per cent interest in the Altius Centre, both in Calgary. These new properties added approximately 526,000 square feet, or 13 per cent to the portfolio. These acquisitions were immediately accretive to both cash flows and earnings.

O&Y REIT's 2002 acquisition program was somewhat frustrated, however, due to the strong investor demand for high quality office properties offered for sale. Despite a decline in office real estate fundamentals, some properties traded at what we believed to be unwarranted prices that were beyond O&Y REIT's investment criteria. Others have been withdrawn from sale because the market would not meet these inflated prices. We believe this situation will correct itself in the mid-term and ultimately reward O&Y REIT's disciplined patience. The REIT will not take on unnecessary risk, nor will it overpay.

Our major development initiative, the 441,000 square foot Maritime Life Tower in downtown Toronto, was completed on March 13, 2003, on time and below budget and began welcoming its first tenants, as planned.

That being said, leasing activity for the Maritime Life Tower – the first new major

construction in this market in nearly a decade – has been slowed by the same softness experienced in most market segments across the country. The building is currently 50 per cent leased and completing the leasing of this property is a major focus for us in 2003. With the limited supply of office space in downtown Toronto, we are in a good position to take advantage of leasing opportunities when market conditions improve. We remain optimistic that when the market does turn around, it will do so in a manner that will see our space in the Maritime Life Tower taken up quickly, as it is the only new office building with significant contiguous space in downtown Toronto.

We firmly believe that the Maritime Life Tower will be both a signal of success for O&Y Properties and an acquisition opportunity for O&Y REIT, which has an option to acquire the property through a development agreement between the two entities.

At our Place de Ville III development site in Ottawa, we were disappointed not to be awarded the federal government's tender for 300,000 square feet of new office space, but we will continue to pursue other leasing opportunities that will allow the project to proceed.

Our real estate services division, O&Y Enterprise, had a mixed year. This business experienced a serious challenge over the past year due to ongoing changes in the real estate services market.

As a result, O&Y Enterprise underwent a substantial restructuring. We have refocused the business on national clients and larger contracts. We also divested ourselves of a portion of our Western regional portfolio of services contracts. At the same time, we centralized our back office services.

In total 253 jobs were affected across the country, of which 143 were transferred in connection with the sale of the Western contracts.

While these restructuring efforts resulted in charges against earnings in 2002, we can be confident that the changes have re-established a sound business footing for the future.

A positive note within our real estate services business was found in our facilities management and corporate real estate services partnership, O&Y CB Richard Ellis Facilities Management, which continued to perform well. It is rapidly establishing

MARITIME LIFE TOWER
*Downtown Toronto's first new major office tower in nearly a decade*

itself, particularly in the financial services sector. The partnership recently won competitive bids for two new facilities management contracts from leading financial services institutions, in addition to the existing CIBC contract awarded last year.

## OUTLOOK

We expect 2003 office market fundamentals to remain challenging. However, there are a number of mitigating factors.

**FIRST,** while vacancy levels have increased, there is generally no significant new supply in the markets in which we operate. This means that when the economy recovers, pent-up demand will quickly be realized.

**SECOND,** our lease expiries for 2003 are low at approximately 6 per cent for both O&Y REIT and First Canadian Place, combined. And, we have already renewed or leased space equivalent to approximately 64 per cent of these expiries.

**THIRD,** we have a strong balance sheet both in O&Y Properties and O&Y REIT. The REIT has in excess of $150 million in acquisition capacity. It has already announced its first acquisitions for 2003. Subsequent to year-end, O&Y REIT announced that it had entered into an agreement to acquire the remaining 50 per cent interest in the Canadian Western Bank Building and Enbridge Tower in Edmonton from its co-owners.

We will continue to make the lease-up of the Maritime Life Tower a priority in 2003 and will look for alternative development opportunities for our Place de Ville III site in Ottawa.

With respect to O&Y Enterprise, we believe that we have repositioned it to operate efficiently and profitably, while providing the highest level of service to clients.

In today's world of rapid change, investors have access to a wide range of investment opportunities that offer an equally wide range of returns. We believe there is a compelling case for choosing a balanced investment, such as O&Y Properties, which has a diversified portfolio of assets and activities, an expert and motivated management team and a strong balance sheet.

We would like to close this letter by acknowledging the commitment and consistent hard work of O&Y Properties Corporation's employees, and our Board of Directors whose guidance has contributed to our success in delivering very solid operating and financial results in 2002, in spite of challenging conditions.

As always, we remain focused on enhancing value and delivering superior investment returns to shareholders.

Philip Reichmann
*Chief Executive Officer*

Frank Hauer
*President*

# Building On Our Strengths

A ROUNDTABLE DISCUSSION WITH OUR MANAGEMENT TEAM

**O&Y Properties Corporation's success depends on the effective planning and implementation of comprehensive business plans – an effort requiring the input and daily attention of senior executives with a range of expertise and experience.**

**In the following section, some of O&Y Properties Corporation's senior managers address questions of interest to shareholders relating to the business environment and to the Company's operations and prospects for future growth.**

**Q What is your approach to property ownership, and how has this changed over the last 18 months to two years?**

**A** FROM JAN SUCHARDA, SENIOR VICE PRESIDENT, ASSET MANAGEMENT

We undertake regular reviews of our property portfolio and, based on our experience and local market knowledge, we assess the opportunities for our properties. Our leasing strategy reflects the property's position within the local marketplace, economic conditions and the status of current tenancies.

We believe that proactive discussions with tenants, staggered lease maturities and contracted rental rate increases can enhance both cash flow and capital value.

In terms of acquisitions of office properties, we have a very disciplined approach to analyzing and underwriting assets.

We will not overpay to acquire new assets simply for the sake of growth. In the current challenging economic environment, we believe a sound strategy involves patience and discipline. We will not abandon the very principles that have delivered solid results to date.

**Q The O&Y Enterprise situation appears to have been a significant challenge, requiring two restructurings in as many years. Why was this necessary, and are you confident the situation has now been turned around?**

**A** FROM GEOFF HARRISON, PRESIDENT, O&Y ENTERPRISE

The third party property management business has contracted over the past couple of years, primarily due to the consolidation of ownership of real estate and the move to internalize the property management function by certain real estate investment trusts. Both of these impacted our business significantly.

Included in the second restructuring, we moved proactively to refocus our business on national clients, larger contracts and major markets. We divested ourselves of a portfolio of smaller Western Canada based service contracts and centralized the management of the business in Toronto. At the same time, we have been investing in a new enterprise resource planning computer system, which supports this new business model and will help us manage our business better.

As a result, we have moved the business to a more sustainable profile, allowing us to improve both financial performance and client service levels.

**Q With the Maritime Life Tower now complete, are you concerned about fully leasing the building? And what does this mean for future development opportunities?**

**A** FROM JOHN LEVITT, SENIOR VICE PRESIDENT, BUSINESS DEVELOPMENT

While we remain confident that the Maritime Life Tower project will prove a success for both O&Y Properties Corporation and O&Y Real Estate Investment Trust, its lease-up is lagging slightly behind our plans, due to the slow-down in office leasing. But with limited supply of office space in downtown Toronto, we are in a good position to take advantage of leasing opportunities when the market conditions improve.

As far as other development opportunities are concerned, we have a number of opportunities that we are pursuing. However, we will not commit the Company's resources to launching any new projects unless we have achieved appropriate pre-leasing thresholds and the project has the appropriate risk profile for the Company.

**Q** **What impact will rising interest rates have on the business of O&Y Properties Corporation?**

**A** FROM RAGS DAVLOOR, CHIEF FINANCIAL OFFICER

The management of O&Y Properties Corporation is firmly committed to maximizing income from its entire property portfolio through prudent and sophisticated financial management including, wherever appropriate, the use of fixed-rate financing suited to the nature of the leases and the properties being financed. We also stagger debt maturities to reduce financing risk and to provide a source of additional capital when refinanced, and make use of operating lines or acquisition facilities to supply interim capital.

Currently only approximately 14 per cent of the Company's secured debt is at floating rates, thereby minimizing exposure to short-term interest rates, while providing us with flexibility.

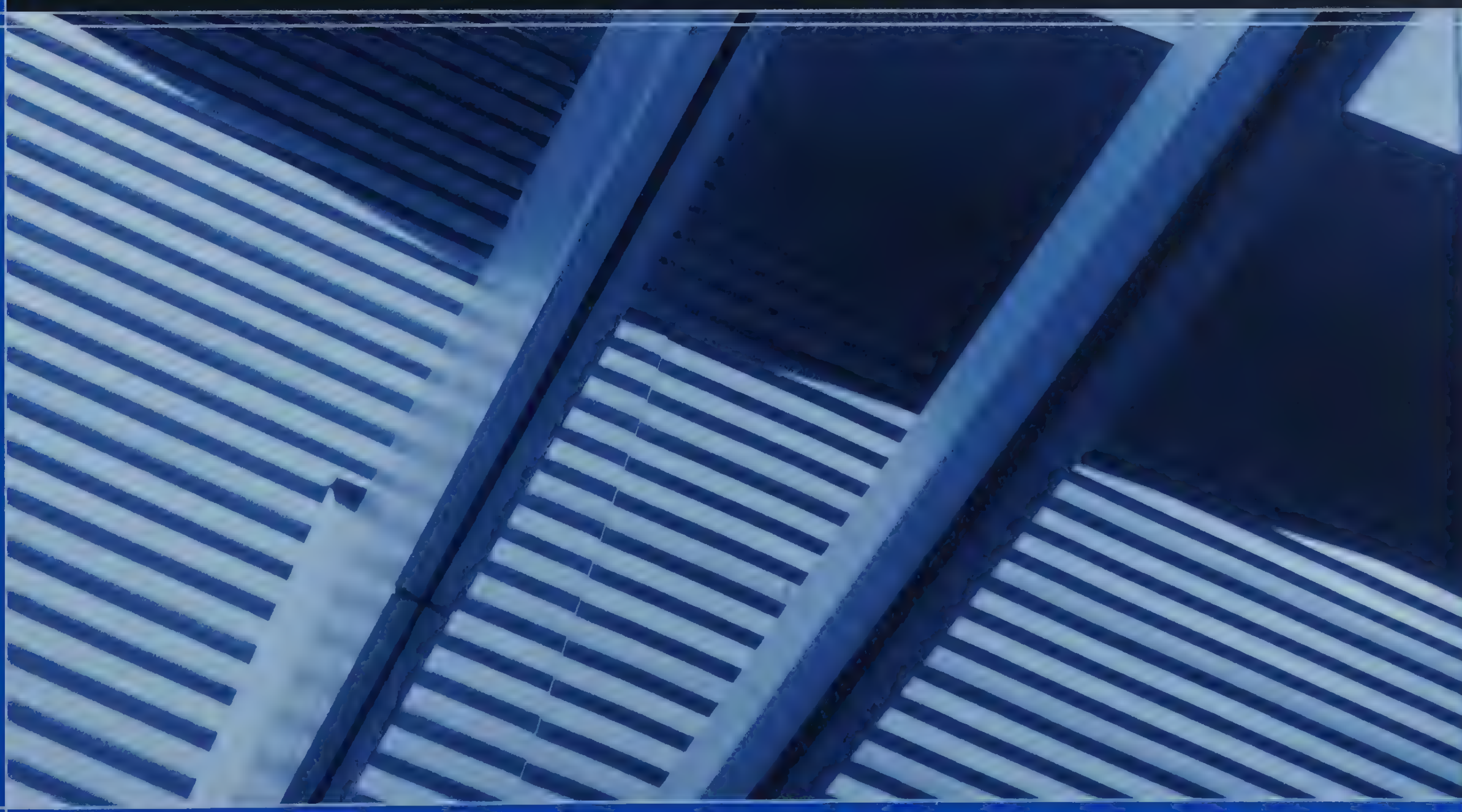
**Q** **Do O&Y Properties Corporation's corporate governance practices meet Toronto Stock Exchange standards?**

**A** FROM RANDY NORTHEY, SENIOR VICE PRESIDENT, GENERAL COUNSEL & SECRETARY

High-profile U.S. business failures – and continuing changes in securities regulations in Canada and the U.S. – have prompted many companies, O&Y included, to increase the time and attention paid to corporate governance. Over the past year, O&Y Properties' senior management team and its Board of Directors have dedicated significant time to ensuring that the Company's governance practices reflect best practices, as well as meeting the new requirements of various regulators. While O&Y Properties has always complied with the TSX's governance guidelines, it is now fully compliant with the new guidelines proposed by the TSX in November 2002, even though they are not yet in force.

While the investment in corporate governance has been significant, we believe it has also repaid the Company well. Good corporate governance has assisted in ensuring a very high standard of disclosure in reporting our operational and financial results. When excellence in disclosure is combined with other good governance practices, stakeholder confidence is improved and that benefits the interests of the Company and all stakeholders.

# MANAGEMENT'S DISCUSSION AND ANALYSIS



O&Y PROPERTIES CORPORATION

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*For the year ended December 31, 2002*

Management's discussion and analysis should be read in conjunction with our financial statements and the notes thereto. Comparative figures for the previous year and references to the prior period relate to the eleven months ended December 31, 2001.

## CORPORATE OVERVIEW

O&Y Properties Corporation ("O&Y Properties") is a Canadian commercial real estate company that is focused on ownership, management and development of high-quality office buildings. Directly and indirectly through just over 50% ownership of O&Y Real Estate Investment Trust ("O&Y REIT"), O&Y Properties owns a portfolio of 21 office properties representing 8.4 million square feet in seven Canadian markets, including the 2.7 million square foot Class AAA First Canadian Place office complex in downtown Toronto. O&Y Properties recently completed construction of the 441,000 square foot, Class A Maritime Life Tower in downtown Toronto. O&Y Enterprise, its real estate services division, is a leading third party commercial real estate manager, specializing in the provision of property management services to owners of real estate. Through a 60% interest in a partnership with CB Richard Ellis called O&Y CB Richard Ellis Facilities Management, it delivers facilities and corporate real estate services to users of real estate. O&Y Enterprise and O&Y CB Richard Ellis have offices in 7 major centres across Canada and employ approximately 1,000 people, servicing a managed portfolio of more than 74 million square feet.

## BUSINESS STRATEGY

Our mission is to maximize shareholder value by delivering solid operating and financial results through the disciplined management and growth of each of our four key business areas. First is O&Y REIT. The launch of O&Y REIT in 2001 created a vehicle with greater access to capital. Our ownership interest in the REIT provides us with strong and steady cash flow and an opportunity for value appreciation as O&Y REIT grows and its cash flow and unit price increases. O&Y REIT is geographically diversified with strong tenant covenants. It owns a national portfolio of 19 high-quality Class A and Class B multi-tenant and government office buildings across Canada totaling 4.7 million square feet at December 31, 2002. The second area of our business is First Canadian Place. As one of Canada's premier business addresses, the property attracts high-quality tenants and provides strong and reliable cash flow. The third area of business is new property development or property redevelopment, both of which provide opportunity for significant value creation. Our fourth area of business is real estate services, a fee-based business primarily performed by O&Y Enterprise and O&Y CB Richard Ellis.

Acquisitions of revenue-producing properties occur through O&Y REIT, while development and redevelopment activities occur through O&Y Properties. O&Y REIT, through a development agreement with O&Y Properties, has the option to purchase these projects once the assets become stable revenue-producing properties.

O&Y Enterprise provides us with a diversified source of income. O&Y Enterprise is also strategic. Through its representation across the country, it provides us with local market knowledge allowing us to better capitalize on real estate opportunities.

We constantly review our property portfolio and assess the ongoing opportunities for our properties. Leasing strategy for each property reflects the nature of the property, its position within the local marketplace, prevailing and forecast economic conditions, the state of the local real estate market and the status of existing tenancies.

We are committed to maximizing income in our areas of business through prudent financial management. Whenever appropriate, we will utilize fixed-rate debt financing with terms which are appropriate for the nature of the leases and the properties being financed. We attempt to stagger our debt maturities to reduce refinancing risk and to provide a source of additional capital when refinanced, and make use of operating lines and/or acquisition facilities to generate interim capital.

*For the year ended December 31, 2002*

## BUSINESS HIGHLIGHTS

In 2002, we recorded basic funds from operations ("FFO") that were ahead of the prior year by 23% at $55.8 million or $1.23 per share, compared to $45.4 million or $0.95 per share. On a per share basis, the increase was 29%.

Despite the challenges that we faced, such as a slowing economy, declining equity markets and increasing office vacancy, we recorded a number of major accomplishments, which included:

- introduction of a quarterly dividend to shareholders equal to $0.20 per share on an annual basis;
- acquisition of $66 million of office properties in O&Y REIT;
- completion of a private placement of $50 million in O&Y REIT, of which O&Y Properties subscribed for just over 50%;
- an increase in O&Y REIT's cash distributions to $1.07 per limited voting unit on an annual basis, from $1.05, providing O&Y Properties with $18.2 million in total distributions from the REIT in 2002;
- completion of leasing in O&Y REIT of 542,000 square feet at an average of $12.95 per square foot, compared to lease expiries of 657,000 square feet at an average of $10.61 per square foot;
- as of February 2003, the renewal or leasing of space equivalent to approximately 84% of O&Y REIT's 2003 expiries;
- agreement with the largest tenant in First Canadian Place, BMO Financial Group, for the early renewal of 423,000 square feet of leases until 2013;
- completion of construction of the Maritime Life Tower on time, with construction costs under budget;
- the award of two new major contracts to our corporate real estate services and facilities management partnership, O&Y CB Richard Ellis; and
- maintenance of a conservative balance sheet with a debt-to-equity ratio at December 31, 2002 of 1.43:1 and an EBITDA[1] interest coverage ratio for 2002 of 2.64:1.

Subsequent to year-end, O&Y REIT announced that it had entered into an agreement to acquire the remaining 50% of the Canadian Western Bank Building and Enbridge Tower in Edmonton from its co-owners.

Throughout the year we were committed to buying back shares and convertible debentures under our normal course issuer bid programs. Our shares have been trading at a significant discount to net asset value, and our convertible debentures are trading at approximately 85 cents to 87 cents to the dollar. We repurchased 592,800 shares over the past fiscal year at an average cost of $5.64 per share and $5.3 million in convertible debentures at a cost of $4.4 million. We also believe that O&Y REIT's limited voting units have, at times, traded at a discount to their value and during 2002, we acquired 47,875 limited voting units through the REIT's Distribution Reinvestment Plan, as well as 93,200 limited voting units on the open market.

A listing of our property portfolio at March 31, 2003 can be found on the inside back cover of this annual report.

[1] EBITDA is calculated as net income plus income tax expense plus interest of others in O&Y REIT plus depreciation and amortization plus financing expense plus other items. EBITDA does not have any standardized meaning prescribed by Canadian generally accepted accounting principles and is therefore unlikely to be comparable to similar measures presented by other companies.

## FINANCIAL HIGHLIGHTS

| *(in thousands of dollars except per share amounts)* | TWELVE MONTHS ENDED DEC. 31, 2002 | ELEVEN MONTHS ENDED DEC. 31, 2001 |
|---|---|---|
| Revenues | $ 291,735 | $ 265,268 |
| Net income | $ 6,320 | $ 10,239 |
| – per share basic | $ 0.04 | $ 0.14 |
| – per share diluted | $ 0.04 | $ 0.14 |
| Funds from operations | $ 55,798 | $ 45,359 |
| – per share basic | $ 1.23 | $ 0.95 |
| – per share diluted | $ 1.09 | $ 0.86 |

For the year ended December 31, 2002, basic FFO was $55.8 million or $1.23 per share ($1.09 per share diluted), compared to the eleven-month period in the prior year of $45.4 million or $0.95 per share ($0.86 per share diluted). The increase in the year-end results was due mainly to strong net rental income from the existing portfolio and newly acquired properties, lower current income taxes and lower financing expense, partly offset by information system implementation costs.

Under relevant accounting standards, FFO is calculated as if O&Y Properties owns 100% of O&Y REIT. If the company calculates FFO on a proportionate basis, basic FFO for the year ended December 31, 2002 would have been $38.0 million or $0.80 per share ($0.75 per share diluted), compared to $37.4 million or $0.76 per share ($0.71 per share diluted) for the eleven months ended December 31, 2001.

These results have been derived as follows:

| *(in thousands of dollars except per share amounts)* | TWELVE MONTHS ENDED DEC. 31, 2002 | ELEVEN MONTHS ENDED DEC. 31, 2001 |
|---|---|---|
| O&Y Properties Corporation consolidated FFO | $ 55,798 | $ 45,359 |
| Less: O&Y REIT FFO | (40,448) | (18,221) |
| Add back elimination of Maritime Life Tower loan interest | 4,403 | 2,219 |
| Add back elimination of intercompany leasing fees | 431 | 136 |
| FFO attributable to all other sources | 20,184 | 29,493 |
| Proportionate consolidation of O&Y REIT FFO | 20,275 | 9,120 |
| Eliminate proportionate share of Maritime Life Tower loan interest | (2,207) | (1,111) |
| Eliminate proportionate share of intercompany leasing fees | (216) | (68) |
| O&Y Properties Corporation proportionately consolidated FFO | $ 38,036 | $ 37,434 |
| – per share basic | $ 0.80 | $ 0.76 |
| – per share diluted | $ 0.75 | $ 0.71 |

After adjusting for the shorter reporting period in the prior year, proportionate FFO for 2002 was behind that of 2001. This was mainly due to the fact that in the prior year O&Y REIT came into existence starting June 27, 2001. Therefore, during 2001, FFO included five months of results based on 100% ownership and six months based on our proportionate share versus a twelve month's proportionate share in 2002.

Since the creation of O&Y REIT, our quarterly FFO per share on a proportionate consolidation basis was as follows:

| *(in thousands of dollars except per share amounts)* | THREE MONTHS ENDED SEPT. 30, 2001 | THREE MONTHS ENDED DEC. 31, 2001 | THREE MONTHS ENDED MAR. 31, 2002 | THREE MONTHS ENDED JUN. 30, 2002 | THREE MONTHS ENDED SEPT. 30, 2002 | THREE MONTHS ENDED DEC. 31, 2002 |
|---|---|---|---|---|---|---|
| O&Y Properties Corporation consolidated FFO | $ 12,763 | $ 13,220 | $ 12,679 | $ 13,422 | $ 14,368 | $ 15,329 |
| Less: O&Y REIT FFO | (9,158) | (9,063) | (9,142) | (10,129) | (10,402) | (10,775) |
| Add back elimination of Maritime Life Tower loan interest | 1,110 | 1,109 | 1,086 | 1,098 | 1,110 | 1,109 |
| Add back elimination of intercompany leasing fees | — | 136 | — | 200 | 160 | 71 |
| FFO attributable to all other sources | 4,715 | 5,402 | 4,623 | 4,591 | 5,236 | 5,734 |
| Proportionate consolidation of O&Y REIT FFO | 4,584 | 4,536 | 4,580 | 5,075 | 5,211 | 5,409 |
| Eliminate proportionate share of Maritime Life Tower loan interest | (556) | (555) | (544) | (550) | (556) | (557) |
| Eliminate proportionate share of intercompany leasing fees | — | (68) | — | (100) | (80) | (36) |
| O&Y Properties Corporation proportionately consolidated FFO | $ 8,743 | $ 9,315 | $ 8,659 | $ 9,016 | $ 9,811 | $ 10,550 |
| – per share basic | $ 0.17 | $ 0.19 | $ 0.18 | $ 0.19 | $ 0.21 | $ 0.23 |
| – per share diluted | $ 0.17 | $ 0.18 | $ 0.17 | $ 0.18 | $ 0.19 | $ 0.21 |

## Net Income

For the year ended December 31, 2002, we recorded net income of $6.3 million or $0.04 per share basic and diluted, compared to $10.2 million or $0.14 per share basic and diluted for the prior period. The decrease related primarily to four factors:

- interest of others in O&Y REIT (minority interest) increased due to the fact that the minority interest's pro-rata share of earnings in O&Y REIT was for six months in 2001 versus twelve months in 2002;
- we recorded a restructuring charge on our real estate services business for $7.0 million;
- a pre-tax accounting gain of $1.8 million was recorded in the prior year in relation to the creation of O&Y REIT; and

• with respect to income taxes, a net tax expense of $0.9 million was recorded for the current year, compared to a net tax recovery of $1.5 million for the prior period.

Income before taxes and other items was $30.2 million, $11.1 million higher than the eleven-month period in the prior year. The increase was due to higher net rental income, lower financing expense and lower depreciation and amortization, partly offset by higher system implementation costs expensed.

## O&Y REIT

2002 represented the first full year of operations for O&Y REIT. Overall, given the current economic environment, we were pleased with its performance. The strategy that we set out to accomplish through the creation of O&Y REIT, being strong and steady cash flow, access to capital markets and the opportunity for value appreciation, is being realized.

The shared management platform, whereby senior management of O&Y Properties perform the same function at O&Y REIT, provides the REIT with access to an experienced and knowledgeable team of professionals familiar with the portfolio, efficiently and cost-effectively.

During the first quarter of the year, O&Y REIT completed a private placement of approximately 4.62 million limited voting units at a price of $10.85 per limited voting unit, for aggregate gross proceeds of just over $50 million. O&Y Properties subscribed for just over 50% of the issue. The net proceeds of the offering were used to fund acquisitions.

O&Y REIT announced four new acquisitions over the course of 2002. The first two acquisitions were in Edmonton, Alberta where the REIT purchased a 50% interest in the Canadian Western Bank Building and the Enbridge Tower. Its two other acquisitions – 1035 – 7th Avenue S.W. and the remaining 50% interest in Altius Centre – were in Calgary, Alberta. 1035 – 7th Avenue S.W. was acquired from O&Y Properties, through O&Y Properties' development agreement with the REIT. Under this agreement, the REIT can assist O&Y Properties in financing new office developments/redevelopment and has the right to purchase the completed buildings.

In February 2002, O&Y REIT announced an increase in its distributions equal to 2 cents per limited voting unit on an annualized basis, which raised the annual distributions from $1.05 per limited voting unit to $1.07 per limited voting unit. The increase reflects the REIT's commitment to increase distributions when prudent.

### Portfolio Overview

The following discussions exclude the impact of the Edmonton acquisitions announced subsequent to year-end, which are discussed later in this report.

O&Y REIT's portfolio of 19 high-quality Class A and Class B income-producing office properties is well diversified, located in Halifax, Ottawa, Toronto, Niagara Falls, Winnipeg, Edmonton and Calgary. Despite the challenging business environment, the portfolio has been performing well, with the decline in overall occupancy rates being substantially offset by new leasing and renewals at higher rates than those at expiry. Overall occupancy in the portfolio at December 31, 2002 was 91.0% compared to 94.1% at December 31, 2001. Part of the decline in occupancy compared to the prior year was due to a decrease in occupancy in Purdy's Wharf, Halifax, in which the REIT owns a 50% interest. A 68,000 square foot lease was not renewed. To date, the REIT has been able to re-lease approximately 45,000 square feet of this space, beginning in the fourth quarter of 2003. In addition, the bankruptcy of one tenant occupying approximately 45,000 square feet of free-standing space in McFarlane Tower, Calgary, also contributed to the decrease in occupancy. The space in McFarlane Tower was previously rented at a rate substantially below market. This gives O&Y REIT the opportunity to retrofit and re-position this space at a higher rate.

Average rent in place for the portfolio was $13.08 per square foot at December 31, 2002, compared to $12.62 per square foot at December 31, 2001.

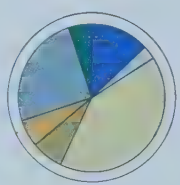
*For the year ended December 31, 2002*

Despite the fact that at the beginning of the year, approximately 12% of O&Y REIT's leases were expiring, it has been able to renew or re-lease a majority of this space. In 2002, approximately 657,000 square feet expired at an average rate of $10.61 per square foot. Leasing activity during the same period amounted to approximately 542,000 square feet at an average rate of $12.95 per square foot. Looking forward, the REIT is fortunate that in 2003, only 7% or approximately 315,000 square feet of leases in its portfolio are budgeted to expire at an average rate of $12.23 per square foot. As of February 2003, the REIT has renewed or leased space equivalent to approximately 264,000 square feet, or 84% of the budgeted 2003 expiries, at an average of $12.24 per square foot.

At December 31, 2002, the portfolio distribution was as follows:

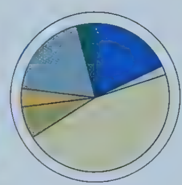
### Gross Leaseable Area ("GLA")

Toronto 13%
Niagara Falls 3%
Ottawa 41%
Halifax 7%
Edmonton 6%
Calgary 25%
Winnipeg 5%



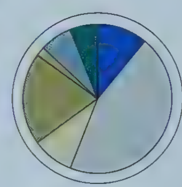
### Gross Revenue from Rental Properties [1]

Toronto 18%
Niagara Falls 2%
Ottawa 46%
Halifax 7%
Edmonton 4%
Calgary 19%
Winnipeg 4%



### Tenant Mix by Gross Revenue [1]

Energy/Resources 11%
Government 45%
Financial Services and Insurance 9%
Service/Professional 20%
Retail 2%
Communications and Information Technology 7%
Other 6%



Note: [1] Excludes parking and storage space revenue except for archival/storage space in Jean Edmonds Towers.

## Lease Data

The overall occupancy rates for the O&Y REIT portfolio at December 31, 2002 and December 31, 2001 were as follows:

| | DEC. 31, 2002 OCCUPANCY [1] | DEC. 31, 2002 AVG. LEASE TERM REMAINING [1] | DEC. 31, 2002 AVG. NET RENT [2] | DEC. 31, 2001 OCCUPANCY [1] | DEC. 31, 2001 AVG. LEASE TERM REMAINING [1] | DEC. 31, 2001 AVG. NET RENT [2] |
|---|---|---|---|---|---|---|
| Halifax | 77.4% | 3.3 YRS. | $ 12.93 | 89.5% | 3.0 YRS. | $ 11.20 |
| Ottawa | 98.4% | 4.1 YRS. | $ 13.44 | 99.0% | 5.0 YRS. | $ 13.38 |
| Toronto | 96.9% | 4.2 YRS. | $ 15.39 | 96.9% | 3.5 YRS. | $ 15.41 |
| Niagara Falls | 95.3% | 3.1 YRS. | $ 6.10 | 97.0% | 3.9 YRS. | $ 5.42 |
| Winnipeg | 80.4% | 2.6 YRS. | $ 10.46 | 78.6% | 2.7 YRS. | $ 10.33 |
| Calgary | 82.4% | 3.6 YRS. | $ 13.46 | 90.1% | 2.8 YRS. | $ 11.38 |
| Edmonton | 85.2% | 4.9 YRS. | $ 10.01 | N/A | N/A | N/A |
| Weighted average | 91.0% | 3.9 YRS. | $ 13.08 | 94.1% | 4.0 YRS. | $ 12.62 |

Notes: [1] Excludes storage space except for archival/storage space in Jean Edmonds Towers.
[2] Certain of the leases are based on semi-gross rents rather than on net rents. The rents shown are estimates of the equivalent to net rents.

Lease expiries for the portfolio as of December 31, 2002 for the next five years are as follows:

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring | 314,794 | 1,025,820 | 483,011 | 394,941 | 429,024 |
| Area/GLA | 7% | 22% | 10% | 8% | 9% |
| Rent per sq. ft. on expiry | $ 12.23 | $ 14.01 | $ 13.95 | $ 14.52 | $ 14.51 |

## Regional Overview

The regional information that follows contains local real estate market data sourced from Insite Altus and Colliers International.

### HALIFAX

The Halifax central business district ended 2002 posting an overall vacancy rate of 9.9% across all classes including all sublet space. The vacancy rate in the Class "A" category was 15%, however approximately 5% of this is directly attributable to the departure of a single government tenant from the REIT's Purdy's Wharf building to a rehabilitated government-owned C class building midway through 2002. This compares to Class A vacancy of 9.8% in the prior year. In the Halifax central business district market, asking net rates posted are in the range of $15.00 to $18.50 per square foot and $8.00 to $14.00 per square foot in the Class A and B segments, respectively.

Purdy's Wharf is a Class AAA office complex and is Halifax's premier office complex. The complex is comprised of 18- and 22-storey office towers and a 4-storey office/retail building, comprising approximately 695,000 square feet in aggregate. Situated directly on the waterfront, it is connected to the city's elevated pedway system, which links the property to the central business district. It is home to many national and international companies that desire a prominent presence in Atlantic Canada. At December 31, 2002, it was 77% leased, generating an average net rent of $12.93 per square foot leased, compared to 89.5% at December 31, 2001 with an average net rent of $11.20 per square foot. During 2002, approximately 86,000 square feet of leases expired at an average rate of $7.89 per square foot. During the same period, 44,000 square feet of leasing activity was completed at an average net rental rate of $14.73 per square foot. The aforementioned results represent O&Y REIT's 50% ownership interest in the property.

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring [1] | 33,571 | 75,258 | 37,550 | 43,003 | 19,034 |
| Area/GLA [1] | 10% | 22% | 11% | 12% | 5% |
| Rent per sq. ft. on expiry | $ 15.42 | $ 5.82 | $ 22.49 | $ 14.58 | $ 21.81 |

Note: [1] Represents the REIT's 50% ownership interest.

### OTTAWA

The federal government is Ottawa's largest employer. The Ottawa downtown real estate market, in which O&Y REIT competes directly, posted an overall vacancy rate of 3.2% across all office classes at year-end 2002, inclusive of sublet space, compared to 2.3% a year earlier. The respective vacancy rates were 3.5% for Class A and 2.6% for Class B buildings. Buildings in the Class A segment have asking net rental rates posted in the range of $18.00 to $29.00 per square foot, whereas Class B buildings have asking net rental rates posted in the $13.00 to $21.00 per square foot range.

The downtown Ottawa office portfolio comprises almost 2 million square feet among three complexes – Place de Ville I and Place de Ville II, both Class A assets and Jean Edmonds Towers, a Class B asset. As of December 31, 2002, the portfolio had an overall occupancy rate of 98%, the vast majority of which represents government tenancies, and was posting an average in-place rent of $13.44 per square foot. This compares to an overall occupancy rate of 99% at December 31, 2001 with an in-place rent of $13.38 per square foot. During 2002, approximately 43,000 square feet of leasing activity in the Ottawa portfolio was completed at an average net rental rate of $15.83 per square foot. This compares to lease expiries of approximately 47,000 square feet at an average net rental rate of $13.28 per square foot during the same period.

Place de Ville I consists of two 22-storey office towers, a below grade retail mall and a five level underground parking facility. The property has 617,500 square feet of gross leaseable area. The lobbies of the office towers are connected at the ground level. The property is situated across the road from, and is linked below grade to, Place de Ville II. The Place de Ville complex is located in the downtown area of Ottawa. It is in immediate proximity to Parliament Hill and is within blocks of the Supreme Court of Canada, the Bank of Canada and numerous other government offices.

Place de Ville I has a mix of public and private sector tenants. The largest tenant is the federal government, which leases approximately 484,000 square feet, nearly 342,000 square feet of which is subject to long-term leases expiring in 2008. The rental rate associated with approximately 59,000 square feet of these leases will reduce by $6.97 per square foot on November 1, 2003, for the remaining five years of the term. The remaining 20% of the office space is leased to private sector tenants and contains a staggered distribution of lease maturities.

Place de Ville I is on land leased from a major life insurance company until the year 2065. Annual land rental payments are $1.46 million until March 2006 and $2.1 million from April 2006 to March 2016. For the periods April 2016 to March 2041 and April 2041 to March 2065, the annual rental payment will be equal to 6 5/8% of the fair market value of the land on March 31, 2015 and March 31, 2040, respectively.

Place de Ville II consists of a 29-storey office tower that is the tallest building in Ottawa, a 4-storey podium building and a below-grade retail mall, containing an aggregate of 667,000 square feet of space. Place de Ville II is located across the road from, and is connected to, Place de Ville I below grade in the retail areas and the garage.

In Place de Ville II, all of the office space and most of the storage area, comprising approximately 600,000 square feet is leased to the federal government pursuant to a long-term lease expiring in 2008. The rental rate associated with the lease will reduce by $6.97 per square foot on November 1, 2003, for the remaining five years of the term. O&Y Properties has provided an income subsidy to O&Y REIT to offset the reduction in revenue. As well, approximately 15,300 square feet is physically located under the property adjacent to Place de Ville II. O&Y REIT will be entitled to earn rental revenue of $410,000 on an annualized basis from this area until it reverts back to the adjacent land owner on October 31, 2003, pursuant to an existing agreement.

Jean Edmonds Towers is located in downtown Ottawa and occupies the westerly two-thirds of the city block bounded by Slater Street, Kent Street, Laurier Avenue and Bank Street. It is two blocks south of the Place de Ville complex. Jean Edmonds Towers is comprised of two 20-storey towers aggregating 648,000 square feet. The towers are connected by a ground level, single-storey pedestrian walkway. The federal government has leased 100% of the office and archival storage space and a portion of the retail space until December 2004, comprising approximately 633,000 square feet.

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring | 30,912 | 737,373 | 48,045 | 12,843 | 25,092 |
| Area/GLA | 2% | 38% | 2% | 1% | 1% |
| Rent per sq. ft. on expiry | $ 11.09 | $ 14.51 | $ 13.87 | $ 16.18 | $ 17.35 |

## SOUTHWESTERN ONTARIO

The Southwestern Ontario portfolio is comprised of the Greater Toronto Area (GTA) properties and Acres House in Niagara Falls. Toronto is the financial and industrial hub of Canada. The city features the headquarters and corporate offices of many of Canada's largest companies, including most of Canada's major banks. In downtown Toronto, the level of leasing activity declined in 2002 – resulting in an increase in overall office vacancy rates to 13.0% at year-end from 9.6% at the end of 2001. A significant component of the vacancy is attributed to the sublet market. Excluding sublet space, the overall vacancy rate drops by 2.3% to 10.7% compared to 7.3% at the end of 2001. Class A vacancy was 12.9% at the end of 2002, declining to 10.7%, if sublet space is excluded. Class B vacancy was 13.7% at the end of the year, declining to 10.8%, if sublet space is removed from the total. Average asking net rental rates posted for downtown Class A space ranged from $24.00 to $36.00 per square foot, with Class B space following at $12.50 to $23.00 per square foot.

In Toronto's midtown real estate market, overall vacancy rates were 10.7% at year-end, compared to 9.4% a year earlier. Asking net rental rates posted for Class A space range from $13.50 to $22.00 per square foot, with Class B space ranging from $10.00 to $18.00 per square foot.

O&Y REIT's Toronto portfolio of nearly 600,000 square feet posted an overall occupancy rate of 97% at year-end, unchanged from the prior year, with an average in-place rent of $15.39 per square foot, compared to $15.41 per square foot in the prior year.

O&Y REIT's 18 King Street East property is located in Toronto's financial district, whereas 2/24 St. Clair Avenue West and 40 St. Clair Avenue West are located in the midtown market. Over the course of the year, approximately 129,000 square feet of leasing activity was completed at an average net rental rate of $16.60 per square foot. Lease expiries during the same period amounted to approximately 132,000 square feet at an average rate of $18.11 per square foot.

18 King Street East is a 17-storey Class B office building containing 233,000 square feet of gross leaseable area. It is located at the corner of King and Victoria Streets, one block east of Yonge Street, the subway and the downtown financial district.

18 King Street East is on land leased from a private company until the year 2067. The rental payment is contracted at fixed levels for the next 16 years. The rent, which has been set at $560,000 for 2003, escalates by approximately $10,000 per year until 2010 when it reaches $650,000, where it remains until 2013. From 2014 to 2018, the annual rental payment increases to $660,000 per year. For the 25 years beginning December 1, 2018, the annual rental payment will be equal to 6 1/2% of the fair market value of the land at the beginning of the period plus 2% of the gross annual income from the property for each year. In no event will the annual rental payment be less than the average rent for the immediately preceding 25 year period. For the 24 years beginning December 1, 2043, the annual rental payment will be calculated in the same manner as during the immediately preceding 25 year period.

2/24 St. Clair Avenue West is a 21-storey, 238,000 square-foot Class B office building. Street level retail is located at the base of the property, with shops fronting onto Yonge Street and St. Clair Avenue. The property is located on the northwest corner of Yonge Street and St. Clair Avenue, steps away from the subway station in midtown Toronto.

40 St. Clair Avenue West is a 13-storey Class B office building comprising 127,000 square feet of gross leaseable area. It is located in close proximity to the corner of Yonge Street and St. Clair Avenue and the St. Clair subway station in midtown Toronto. The building is substantially leased to the provincial government until 2007.

Built in 1995, Acres House is a Class A, 149,500 square-foot building in downtown Niagara Falls. The principal tenants consist of consulting and engineering firms. As of December 31, 2002, Acres House was 95% leased, generating average net rent of $6.10 per square foot, compared to 97% at December 31, 2001 at $5.42 per square foot.

*For the year ended December 31, 2002*

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring | 91,101 | 35,201 | 117,085 | 125,090 | 181,739 |
| Area/GLA | 12% | 5% | 16% | 17% | 24% |
| Rent per sq. ft. on expiry | $ 14.06 | $ 14.73 | $ 13.34 | $ 14.72 | $ 12.76 |

WINNIPEG

The City of Winnipeg posted a downtown office vacancy rate of 8% at the close of 2002, compared to 7% at the end of 2001. Downtown Class A vacancy was 9.4%, decreasing to 7.2% if sublease space is excluded from the total. The Class B market posted a vacancy rate of 5.9%, decreasing to 4.1% if sublease space is excluded from the total. In 2002, Class A asking net rental rates posted ranged from $13.50 to $16.50 per square foot, while Class B asking net rental rates posted ranged from $8.50 to $12.50 per square foot.

O&Y REIT's properties consist of two buildings. 330 St. Mary Avenue is a 12-storey Class A office building located at the southeast corner of St. Mary Avenue and Hargrave Street in downtown Winnipeg. The property is across the road from Eaton Place Mall and one block east of the city's convention centre. The building has 150,000 square feet of gross leaseable area.

175 Hargrave Street is a 71,000 square-foot, 7-storey Class B office building immediately south of 330 St. Mary Avenue. Both offer a cost-effective alternative to properties at Portage and Main Streets.

The overall occupancy rate of the Winnipeg portfolio was 80% at year-end, generating net rent of $10.46 per square foot, compared to 79%, generating net rent of $10.33 per square foot at December 31, 2001. During 2002, lease expiries totaled approximately 53,000 square feet at an average net rental rate of $11.31 per square foot. During the same period, 58,000 square feet of leasing activity was completed at an average net rental rate of $11.22 per square foot.

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring | 49,404 | 14,592 | 63,440 | 15,664 | 12,307 |
| Area/GLA | 22% | 7% | 29% | 7% | 6% |
| Rent per sq. ft. on expiry | $ 9.64 | $ 11.90 | $ 11.03 | $ 9.90 | $ 11.95 |

CALGARY

The 2002 year-end downtown Calgary vacancy rate was 13.3%, including the sublet market, compared to 9.8% a year earlier. If the sub-lease segment is excluded from the total, this rate declines to 9.3%, compared to 7.8% at the end of 2001. In the northeast Calgary suburban market node, the 2002 year-end vacancy rate was 20.3% including the sublet market, compared to 14.4% a year earlier. Average downtown asking net rental rates posted for Class A space range from $15.00 to $26.00 per square foot, and $11.50 to $19.00 per square foot for Class B space. Average suburban asking net rental rates posted in the northeast sector range from $10.50 to $16.50 per square foot for Class A space and $7.00 to $12.00 per square foot for Class B space.

O&Y REIT owns seven office buildings in Calgary, five of which are downtown and two in the northeast quadrant. All of O&Y REIT's office buildings are Class B properties, except for Altius Centre, which is a Class B+ property.

Altius Centre is a 31-storey office building located in the Eau Claire District of Calgary's downtown office market. The building offers 305,000 square feet of gross leaseable area. It is connected to the city's elevated skywalk system, referred to as the Plus 15 System, which links Altius with the city's downtown core and amenities.

840 – 7th Avenue S.W. is a 20-storey, 262,500 square-foot office building located in the west end of Calgary's downtown core. It is part of a mixed-use complex, which includes a hotel, retail shops and underground parking. The complex is located on the Light Rail Transit system and is also connected to the Plus 15 System.

McFarlane Tower is an 18-storey office building located on 4th Avenue in Calgary's downtown west core. The building has a gross leaseable area of approximately 243,000 square feet.

1035 – 7th Avenue S.W. is a 76,500 square-foot office building located in the west end of Calgary's downtown core. This property was substantially renovated by O&Y Properties in 2001/2002 and was subsequently leased to AltaLink and SNC Lavalin, prior to being acquired by O&Y REIT in 2002. The complex is located near the Light Rail Transit system.

Mount Royal Place is a 56,000 square-foot, 6-storey office building located in Calgary's Beltline office market. It is located on a prominent corner fronting 8th Street West, north of 14th Avenue South. The building is located in the southern end of the Beltline office market, adjacent to the affluent Mount Royal neighbourhood.

Franklin Atrium is a 2-storey suburban office building located in the northeast quadrant of Calgary in an office/industrial park referred to as the Franklin Industrial Park. The location provides easy access to the downtown core, airport and Light Rail Transit system. In aggregate, the property contains 144,000 square feet of gross leaseable area.

Franklin Building is a 2-storey, suburban office building also located in the Franklin Industrial Park. It is in close proximity to all amenities, including the airport and the Light Rail Transit system. The building has 51,000 square feet of gross leaseable area.

At year-end, the overall occupancy rate for the Calgary properties was 82% with in-place rents of $13.46 per square foot, compared to 90% at December 31, 2001 with in-place rents of $11.38 per square foot. During 2002, approximately 192,000 square feet of leasing activity was completed at an average rate of $12.25 per square foot. This compares to lease expiries of approximately 265,000 square feet, at an average net rental rate of $8.69 per square foot.

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring | 93,906 | 141,493 | 203,257 | 189,151 | 153,587 |
| Area/GLA | 8% | 12% | 18% | 17% | 13% |
| Rent per sq. ft. on expiry | $ 12.25 | $ 16.84 | $ 14.00 | $ 15.05 | $ 16.90 |

EDMONTON

The City of Edmonton posted a downtown office vacancy rate of 12.3% at the close of 2002, compared to 10.2% at the close of 2001. Downtown Class A vacancy was 11.3%. The Class B market posted a vacancy rate of 12.0%. In 2002, Class A asking net rental rates posted ranged from $7.00 to $12.00 per square foot, while Class B asking net rental rates posted ranged from $4.50 to $8.00 per square foot.

Enbridge Tower is a Class A 20-storey office building comprising 187,000 square feet of gross leaseable area. The property is located in the financial core and has good access to Edmonton's Light Rail Transit system. The building is substantially leased to Enbridge until 2008.

Canadian Western Bank Building is a Class A 30-storey office building with 408,000 square feet of gross leaseable area. It is located in the city's financial core and has direct access to both Edmonton's Light Rail Transit and Pedway systems.

The Edmonton portfolio closed 2002 with an overall occupancy rate of 85%, generating net rent of $10.01 per square foot. For the ten months ended December 31, 2002 (as the properties were acquired in March 2002), there were approximately 21,000 square feet of leases expiring at an average net rental rate of $3.20 per square foot. Leasing activity totaled approximately 27,000 square feet, at an average net rental rate of $6.35 per square foot. The aforementioned expiring and leased areas represent O&Y REIT's 50% interest in the properties.

*For the year ended December 31, 2002*

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring [(1)] | 15,900 | 21,903 | 13,634 | 9,190 | 37,265 |
| Area/GLA [(1)] | 5% | 7% | 5% | 3% | 13% |
| Rent per sq. ft. on expiry | $ 5.20 | $ 7.44 | $ 8.77 | $ 6.29 | $ 8.39 |

Note: [(1)] Represents the REIT's 50% ownership interest.

## Net Rental Income

For the year ended December 31, 2002, net rental income for the O&Y REIT properties was $56.5 million, compared to $48.0 million for the eleven months in the prior year. Even after adjusting for the shorter reporting period in the prior year, net rental income was ahead of the prior year. The increase was mainly due to the growth in income from new property acquisitions. If acquisitions were excluded from the year ended December 31, 2002, net rental income would have been $53.1 million. The increase on a "same-store" basis was due to strong leasing activity in Calgary and a one-time lease termination fee in Winnipeg, partly offset by higher vacancy in Halifax.

## Acquisitions

During the year, O&Y REIT announced four acquisitions. These included the purchase of a 50% interest in the Canadian Western Bank Building and Enbridge Tower, both located in Edmonton's central business district. These acquisitions closed in mid-March 2002. The purchase price for the REIT's 50% share of the buildings was $22.1 million (after factoring in closing costs and working capital adjustments), generating an initial unlevered yield of approximately 11%. The blended cost of the acquisitions was $75 per square foot. The acquisitions were financed with cash and $12.7 million of mortgages at a weighted average interest rate of 6.58%. The levered yield on equity was approximately 17%.

In April 2003, O&Y REIT announced that it had entered into an agreement to purchase the remaining 50% interest in the Canadian Western Bank Building and Enbridge Tower from its co-owners. The total purchase price for the remaining 50% interest in the two buildings is $23.25 million. The acquisitions are expected to close by the end of May 2003. The acquisitions will be financed through the assumption of the vendors' share of the mortgages, amounting to $12.3 million, with the remainder funded through the REIT's operating/acquisition facility. The mortgages to be assumed carry a weighted average interest rate of 6.58%. Going in, the expected blended yield of the acquisition is approximately 11.25% on an unlevered basis and 17% on a levered basis.

In addition, O&Y REIT acquired two properties in downtown Calgary, 1035 – 7th Avenue S.W. and the remaining 50% interest in Altius Centre. The REIT acquired 1035 – 7th Avenue S.W. for $11 million from O&Y Properties in June 2002 through its development agreement with O&Y Properties. The building was 92% leased when acquired. The unlevered yield on the acquisition was 10.5%. The acquisition was paid for with cash on hand. The asset was subsequently pledged under the operating/acquisition facility and forms part of the pool of collateral for that facility. In addition, the REIT recently secured a lease expansion agreement with an existing tenant that will bring the occupancy to 100%.

The 50% interest in Altius Centre that O&Y REIT did not already own was purchased for $32.5 million from its co-owner in the property in October 2002. The unlevered yield on the gross purchase price was approximately 9.25%. In connection with the purchase, O&Y REIT assumed its former co-owner's interest in the property's mortgage, amounting to $16.2 million, which carries a rate of interest of 6.63%. On a levered basis, the yield on equity was approximately 12%.

### Financial Position

O&Y REIT's balance sheet is strong with a conservative debt profile. The relatively low level of debt provides it with the capacity to make acquisitions as opportunities present themselves. Given the REIT's objectives, its approach to leverage will continue to be conservative. O&Y REIT's Declaration of Trust limits the overall debt to 60% of gross book value, excluding convertible debentures, and 65% of gross book value including convertible debentures.

Currently, approximately 13% of O&Y REIT's debt (excluding the convertible debentures owned by O&Y Properties) is at floating rates. The weighted average interest rate on fixed-rate debt was 7.23% and on floating rate debt was 4.7% at year-end. The REIT's debt-to-gross book value ratio (including its convertible debentures) was 46% at December 31, 2002. Excluding the convertible debentures, debt-to-gross book value was 34%. The EBITDA interest coverage ratio for the year was 2.80:1. EBITDA is calculated as net income plus depreciation and amortization plus financing expense. EBITDA does not have any standardized meaning prescribed by Canadian generally accepted accounting principles and is therefore unlikely to be comparable to similar measures presented by other companies.

Fixed-rate debt maturities in O&Y REIT are as follows:

| *Year ending December 31* | BALANCE MATURING ($000s) | % OF DEBT MATURING (%) | WEIGHTED AVERAGE RATE ON EXPIRY (%) |
|---|---|---|---|
| 2003 | $ 34,025 | 21% | 6.62% |
| 2004 | — | — | — |
| 2005 | 57,071 | 35 | 7.61 |
| 2006 | 6,059 | 4 | 5.98 |
| 2007 | — | — | — |
| Thereafter | 67,837 | 40 | 7.25 |
| | $ 164,992 | 100% | 7.23% |

O&Y REIT's floating rate debt is comprised of $30 million outstanding under an $80 million operating/acquisition facility. At December 31, 2002, based on the current pool of assets securing the facility, up to $74.6 million was available to draw. O&Y REIT is currently reviewing all of its debt and debt maturities and is looking to refinance certain assets and substitute other assets as collateral for the operating/acquisition facility. It is currently in the process of refinancing 840 – 7th Avenue S.W. with a fixed-rate mortgage of $23.25 million at an interest rate of 6.60% for a ten-year term. This asset is one of the assets securing the operating/acquisition facility. The REIT intends to replace 840 – 7th Avenue S.W. in the operating/acquisition facility with Altius Centre when its mortgage matures in July. As a consequence, total availability under the facility is expected to increase to $80 million.

Based on these refinancing initiatives, O&Y REIT has the capacity for an additional $150 million to $200 million in property acquisitions.

### FIRST CANADIAN PLACE

A landmark complex at the corner of King and Bay Streets in downtown Toronto, First Canadian Place is composed of a 72-storey Class AAA office tower. First Canadian Place contains approximately 2.7 million square feet of gross leaseable area. First Canadian Place is a core holding and provides us with strong and reliable cash flow given the nature of its high-quality tenants.

*For the year ended December 31, 2002*

The information in the following paragraph contains local real estate market data sourced from Insite Altus.

In downtown Toronto, if the bank towers in the financial core are viewed separately, excluding sublet space, the vacancy rate at December 31, 2002 was 5.5%. As of the fourth quarter 2002, average asking net rental rates posted for the bank towers ranged from $24.00 to $36.00 per square foot.

The occupancy rate for the office component of First Canadian Place at December 31, 2002 was 94.3%, as compared to 98.6% at December 31, 2001. Average rent in place at December 31, 2002 was $22.28 per square foot compared to $21.95 per square foot a year ago.

In September 2002, Manulife Financial announced that it had acquired BMO Financial Group's interest in the land under First Canadian Place to increase its interest in the land from 25% to 50%. O&Y FPT Inc., our wholly-owned subsidiary, owns the other 50% interest in the land and a 100% interest in the building. In connection with this transaction, we negotiated the early renewal of leases for BMO Financial Group totaling approximately 423,000 square feet of space until 2013 at an average rate of $27.50 per square foot. All of the space would have expired at an average rate of $27.81 per square foot. Approximately 110,000 of the 423,000 square feet of space was scheduled to expire in 2003 at an average rate at expiry of $16.14 per square foot, with the remainder set to expire in 2005 at $31.92 per square foot. As part of the agreement, BMO Financial Group surrendered approximately 30,000 square feet of space effective January 1, 2003, which was scheduled to expire in 2005 at a rate of $4.50 per square foot.

The impact of this early renewal by the BMO Financial Group is significant in terms of providing financial stability for First Canadian Place until 2013, as the BMO Financial Group is one of the building's largest tenants. In addition, it minimizes the impact on lease expiries for 2003 and 2005. After factoring in the BMO early renewal, office lease rollovers in the building have been significantly reduced over the next few years. In fiscal 2002, approximately 88,000 square feet of office leasing activity was completed at an average rate of $29.65 per square foot. This compares to office lease expiries of approximately 177,000 square feet at an average rate of $26.26 per square foot.

Lease expiries for the office component of First Canadian Place as of December 31, 2002 for the next five years are as follows:

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring (office) | 116,688 | 90,358 | 242,482 | 106,055 | 252,058 |
| Area/GLA [1] | 5% | 4% | 10% | 4% | 11% |
| Rent per sq. ft. on expiry | $ 19.55 | $ 33.04 | $ 22.25 | $ 24.93 | $ 22.21 |

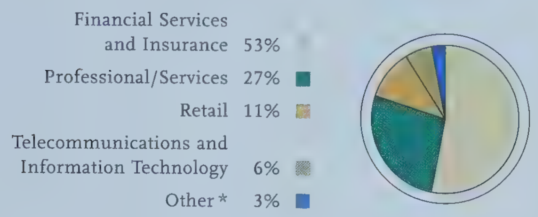
Note: [1] Represents the percentage of the office component of the building only.

Lease expiries for the retail component of First Canadian Place as of December 31, 2002 for the next five years are as follows:

| *Year ending December 31st* | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Sq. ft. expiring (retail) | 4,167 | 30,441 | 17,358 | 41,858 | 844 |
| Area/GLA [1] | 2% | 13% | 7% | 18% | 1% |
| Rent per sq. ft. on expiry | $ 46.85 | $ 23.93 | $ 41.58 | $ 19.72 | $ 94.20 |

Note: [1] Represents the percentage of the retail component of the building only.

The following chart shows the tenant mix for First Canadian Place at December 31, 2002 on the basis of gross revenues.




* Includes government & energy sectors.

Our interest in First Canadian Place consists of a 50% freehold interest in the land, a 50% leasehold interest in the land and a 100% ownership interest in the building. In 2023, our interest in First Canadian Place will convert to a 50% co-ownership interest in the land and building. Our 50% leasehold interest in the land is governed by a land lease with Manulife. Under the land lease, we coordinate our efforts with Manulife through a committee that oversees the performance of the property. During the term of the land lease, Manulife is entitled to certain payments to the extent cash is available.

The land lease provides for variable land rent payments to Manulife based, in part, on the cash flow of the property after certain preferred entitlements to O&Y Properties and Manulife. As a result of the settlement of a dispute regarding the right to receive one of the preferred entitlements, we expect to receive a higher preferred entitlement commencing in the second half of 2003. The effect of the increased entitlement is that the land rent payments to Manulife are expected to be reduced by approximately $20 million over a twelve month period, of which approximately half is expected to be realized in the second half of 2003 and the balance in the first half of 2004. After this entitlement is paid, the land rent payments to Manulife are expected to approximate current levels.

During 2001 and 2002, we continued the repair and maintenance program on the exterior marble cladding of the building and replaced a number of panels due to normal wear. In the latter half of 2001, a review by an independent consultant was initiated to augment previous studies undertaken in connection with this maintenance program. The consultant issued a final report, indicating that the condition of the marble cladding is generally good and that the panels can be maintained with a continuing program of routine surveys and occasional replacements.

### Net Rental Income

For the year ended December 31, 2002, net rental income from First Canadian Place was $42.6 million, compared to $38.6 million for the eleven months ended December 31, 2001. Net rental income was strong and, after factoring in the impact of the shorter reporting period in the prior year, outperformed the prior year. This was the result of a prior year realty tax adjustment recognized in 2002, as well as a non-recurring adjustment made to operating cost recoveries which positively impacted earnings, partly offset by an increase in the vacancy rate in the building.

### Financial Position

The debt on First Canadian Place consists of first mortgage bonds. The bonds are secured under a bond indenture by a fixed and floating charge and security interest on all assets of O&Y FPT Inc., including its interest in First Canadian Place. The bonds mature on December 1, 2009. At that time, the principal balance maturing will be approximately $230 million.

*For the year ended December 31, 2002*

## PROPERTY DEVELOPMENT

Property development and redevelopment is strategically an important area of our business as it provides the opportunity for significant value creation and provides O&Y REIT with acquisition opportunities to grow its portfolio. We take a disciplined approach before proceeding with a development project to ensure the risks are contained. Adequate pre-leasing and financing commitments must be in place before we proceed. At December 31, 2002, our assets employed in property development, including property under development and land held for development, totaled $119.1 million, of which $104.4 million relates to the Maritime Life Tower development project in downtown Toronto.

The Maritime Life Tower development project was completed on time on March 13, 2003, with construction costs under budget and with lease commitments for 50% of the gross leaseable area, up from the beginning of the year, but below expectations. Tenants began moving in on schedule during the early months of 2003, with the bank branch occupied by the Bank of Montreal in late-January and major office tenants, including Maritime Life, occupying in the spring. Leasing activity in the Maritime Life Tower has been constrained by the challenging economic environment, with many major tenants postponing commitments for renewals or expansion space until a positive business climate becomes more certain. Break-even cash flow after debt service on the construction facility is expected to be achieved at between 55% and 60% occupancy.

We have an $82.7 million construction facility on the Maritime Life Tower development project. Interest is at the rate of Prime plus 1.50% and matures in June 2004. At December 31, 2002, $51.0 million was drawn. During the year, the construction facility was fully funding our construction costs. In 2002, $49.5 million was spent on the Maritime Life Tower project. At December 31, 2002, the cost to complete the property was approximately $10 million.

The equity component of the development of the Maritime Life Tower was funded internally by O&Y REIT through a $40 million mezzanine loan facility, which bears interest at 11%. This loan is to be repaid on the earlier of the purchase of the property by O&Y REIT pursuant to the development agreement or December 31, 2004.

During the year, we acquired the remaining 50% interest in the Place de Ville III development site in Ottawa from our joint venture partners. The total purchase price was $7.1 million, satisfied through the assumption of a $2.6 million mortgage and $4.5 million in cash. The assumed mortgage was subsequently repaid. Place de Ville III is located in downtown Ottawa at the corner of Queen and Kent Streets and across the street from O&Y REIT's Place de Ville complex. This site can accommodate a 500,000 square foot office complex and represents an attractive development opportunity. Unfortunately, we were unsuccessful in winning the bid for the federal government's tender for new office space in downtown Ottawa, which we had hoped would launch our Place de Ville III site. Despite the initial setback, we continue to seek an anchor tenant with which to launch construction of one of two buildings planned for the property.

During 2002, we completed our redevelopment and re-leasing of 1035 – 7th Avenue S.W. (Pembina Place), a 6-storey, 76,500 square foot office building located on the western edge of Calgary's downtown core, which we sold to O&Y REIT following the redevelopment, for $11 million.

O&Y Properties is one of six equal shareholders in Union Pearson Group Inc., which was selected in July 2002 to negotiate with the City of Toronto for the right to restore and renovate Union Station. At the conclusion of a pre-qualification process, three responding groups were short-listed and in the end, only two final bids were submitted. The City created an evaluation committee, which selected Union Pearson Group Inc.'s bid. City staff therefore recommended to City Council that they attempt to negotiate a transaction. City Council has suspended making a decision on the awarding of the project, pending a review of the process, which has been undertaken by Mr. Justice Osborne. We understand that his report will be presented to City Council in May.

We are currently pursuing several other development initiatives. Although not all of these initiatives will come to fruition, we do expect some of them to proceed. Our strong capital base and liquidity enable us to pursue these opportunities and we will maintain a cautious and disciplined approach before we proceed with any new developments.

Through a development agreement, O&Y REIT has the option to purchase future development projects upon completion. In addition, it has the right to provide mezzanine loans to fund the equity component of those future development projects, thereby providing us with a source of capital, if required.

## REAL ESTATE SERVICES

Our real estate services business continues to play an important role in our business strategy. This business is strategic in that it provides us with the representation in the local markets where we invest, allowing us to manage our properties and capitalize on potential opportunities. The third party services business provides us with an additional source of income and allows us to leverage our technology platform.

Operationally, our real estate services division, O&Y Enterprise, had a mixed year. Real estate services income before consolidation and other adjustments for the year ended December 31, 2002 was $9.0 million, compared to $7.7 million for the eleven months in the prior year. After taking into account the shorter reporting period in the prior year, real estate services income was higher on a comparative basis. The increase was primarily due to higher transaction-related fees for leasing.

Due to ongoing changes in the real estate services markets, O&Y Enterprise underwent a significant restructuring in the fourth quarter. We have refocused our real estate services business on national clients and larger contracts in major markets across Canada. As a result of this shift in our focus, a $7.0 million charge was incurred relating to severance and other costs required to restructure this business.

In connection with the restructuring, subsequent to year-end, we completed the sale of a portion of our western regional real estate services business to a new property management company led by a former O&Y Enterprise employee. The business sold was comprised of approximately 120 properties under management, containing over 8 million square feet. Management of the properties was transferred effective January 1, 2003.

In total 253 jobs, representing approximately 22% of the real estate services workforce, were affected across the country by the restructuring, of which 143 were transferred in connection with the sale of the western portfolio. Also, as part of the restructuring initiative, we continued to upgrade our technology through the implementation of our Enterprise Resource Planning computer system. At the end of 2002, the total cost associated with the Enterprise Resource Planning computer system implementation was approximately $8.5 million, of which approximately $5.1 million (relating primarily to new hardware and software) has been capitalized and approximately $3.4 million (relating primarily to process re-engineering and training costs) has been expensed. In 2002, $3.1 million was expensed as system implementation costs.

Subsequent to year-end, we announced that we had entered into discussions with Bentall Capital Limited Partnership to pursue a potential combination of our Canadian property management, facilities management and leasing businesses. This combination was to provide the opportunity to share resources and information technology platforms over a larger base, the result of which was expected to be beneficial to both parties and further improve the quality of service provided to clients across Canada.

Our announcement early in the process was the result of our need to speak to clients about the discussions and our desire to ensure that first, this information was not the subject of rumours and misstatements, and second, to ensure that there was full disclosure to all.

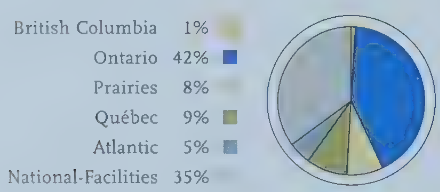
After going through the due diligence process, it was mutually agreed by both parties to discontinue our discussions. The parties entered into discussions with the belief that our real estate services businesses were complementary in many areas, including a strong client service focus, and that a combination would be mutually beneficial. While the due diligence process substantiated the similarities, the review showed that there were insufficient synergies available from such a merger to offset the considerable costs of integration. As a result, our real estate services business will continue to move forward with the business plan that was put in place before the merger talks arose, and will continue to focus on growth opportunities across its various business lines.

*For the year ended December 31, 2002*

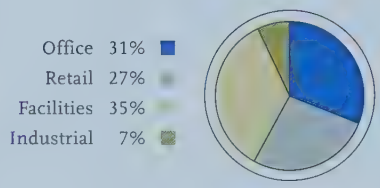
One of the highlights of our real estate services business during the year was the success of O&Y CB Richard Ellis Facilities Management. O&Y CB Richard Ellis, our partnership with CB Richard Ellis, was formed in 2001 to pursue a new area of business, facilities management and corporate real estate services in Canada. We believe that facilities management and corporate real estate services will be a growth area for our services business. Corporate real estate services on behalf of major institutions is a relatively new field in Canada. As corporations focus on their core competencies, contracting out these non-core services is a viable alternative, which provides us with significant growth potential. In addition to the existing CIBC contract awarded last year, O&Y CB Richard Ellis was awarded two new contracts with financial services institutions.

The following tables provide a breakdown of properties managed by our real estate services division by region and type as of December 31, 2002:

Properties under Management by Region




Properties under Management by Property Type




## FINANCING EXPENSE

Financing expense for the year ended December 31, 2002 was $35.0 million, compared to $35.1 million in the eleven months in the prior year. For the year, after adjusting for the impact of the shorter reporting period, financing expense decreased on a comparable basis from the prior year. The decrease resulted primarily from the repayment of $43 million of debt in 2001 as a result of the creation of O&Y REIT, as well as lower interest rates on floating rate debt, partly offset by the addition of interest expense on debt incurred to finance property acquisitions by O&Y REIT.

Financing expense relating to fixed-rate debt amounted to $39.5 million and on floating rate debt amounted to $2.8 million. Interest income netted against financing expense was $1.1 million during the year. Interest capitalized to the Maritime Life Tower development project and other land held for development was $6.2 million. Financing expense would be impacted by $0.3 million per annum (net of amounts capitalizable) or $0.01 per share if short-term interest rates were to change by 1%.

During the year, $17.5 million of debt was repaid by O&Y REIT.

## CORPORATE EXPENSES

Corporate expenses for the year ended December 31, 2002 were $10.1 million, compared to $8.3 million in the prior year. After adjusting for the impact of the shorter reporting period, corporate expenses on a comparable basis were higher than the prior year as a result of the full year impact of the new public entity costs associated with the administration of O&Y REIT.

## DEPRECIATION AND AMORTIZATION

Depreciation and amortization was $27.2 million for the twelve months ended December 31, 2002 compared to $30.0 million for the eleven months ended December 31, 2001. The decrease was primarily due to the change in accounting policy with respect to the amortization of goodwill and management contracts, partially offset by increased depreciation arising from acquisitions.

## LIQUIDITY AND CAPITAL RESOURCES

For the O&Y REIT properties, we spent $3.5 million in 2002 on capital expenditures and deferred costs relating to repairs and replacement of equipment and $5.4 million on tenant inducements and leasing costs (net of intercompany leasing fees). This compares to $6.0 million and $5.1 million, respectively, in the prior year. At First Canadian Place, we spent $5.4 million on capital expenditures and deferred costs relating to repairs and replacement of equipment and $22,000 on tenant inducements and leasing costs. This compares to the prior year of $3.0 million and $0.4 million, respectively. The decrease in capital expenditures and deferred costs in O&Y REIT compared to the prior year, mainly related to the timing of certain expenditures as well as large expenditures on a retrofit of one building in Calgary in the prior year. The increase in capital expenditures and deferred costs in First Canadian Place mainly related to costs expended on our ongoing repair and maintenance program on the exterior marble cladding of the building. In addition to the above, we also spent $2.2 million in tenant inducements and leasing costs on our 1035 – 7th Avenue S.W. redevelopment project, subsequently sold to O&Y REIT.

For fiscal 2003, excluding the impact of any acquisitions during 2003, O&Y REIT expects to incur $5.6 million in capital expenditures and deferred costs, of which $0.9 million is recoverable from tenants. Leasing costs are expected to be approximately $6.7 million. The REIT will fund these expenditures from distributable income not distributed to unitholders, cash on hand and its operating/acquisition facility.

At First Canadian Place for fiscal 2003 we expect to incur $4.1 million in capital expenditures and deferred costs, of which $3.7 million is recoverable from tenants. Leasing costs are expected to be approximately $2.1 million. These expenditures will be funded from cash flow from the property.

Cash and cash equivalents at the end of the period were $28.7 million of which $11.8 million is held, in part, pursuant to the terms of joint venture arrangements and in part, under the terms of various debt agreements. Also included in cash and cash equivalents is $6.1 million held by O&Y REIT.

During the year, $6.1 million in dividends were paid to shareholders, as a result of the introduction of our quarterly dividend policy earlier in the year.

Distributions to other unitholders in O&Y REIT during the year was $18.5 million, of which $0.7 million was reinvested in limited voting units of O&Y REIT pursuant to its distribution reinvestment plan ("DRIP"). This compares to $8.2 million in the prior year, of which $0.1 million was reinvested in limited voting units pursuant to O&Y REIT's DRIP. The increase over the prior year was due to the current year reflecting twelve months of distributions as compared to six months in the prior year, the increase in distributions to $1.07 per limited voting unit from $1.05 per limited voting unit and the increase in the number of limited voting units outstanding due to the private placement. Cash distributions received by O&Y Properties in 2002 amounted to $18.2 million, of which $0.5 million was reinvested in limited voting units of O&Y REIT pursuant to O&Y REIT's DRIP.

We have a conservative balance sheet with a debt-to-equity ratio of 1.43:1 at December 31, 2002. Our EBITDA interest coverage ratio for 2002 was 2.64:1. EBITDA is calculated as net income plus current and future income taxes, interest of others in O&Y REIT, depreciation and amortization and financing expense and other items.

*For the year ended December 31, 2002*

## QUARTERLY INFORMATION

*(in thousands of dollars except per share amounts)*

The following table shows quarterly information for revenues and net income for 2002 and 2001.

| | THREE MONTHS ENDED DEC. 31, 2002 | THREE MONTHS ENDED SEPT. 30, 2002 | THREE MONTHS ENDED JUN. 30, 2002 | THREE MONTHS ENDED MAR. 31, 2002 | THREE MONTHS ENDED DEC. 31, 2001 | THREE MONTHS ENDED SEPT. 30, 2001 | TWO MONTHS ENDED JUN. 30, 2001 | THREE MONTHS ENDED APR. 30, 2001 |
|---|---|---|---|---|---|---|---|---|
| Revenues | $ 75,511 | $ 71,633 | $ 71,550 | $ 73,041 | $ 70,553 | $ 73,224 | $ 48,385 | $ 73,106 |
| Net income | $ 360 | $ 1,822 | $ 2,901 | $ 1,237 | $ 1,574 | $ 267 | $ 6,066 | $ 2,332 |
| – per share basic | $ (0.02) | $ 0.01 | $ 0.04 | $ — | $ 0.01 | $ (0.02) | $ 0.12 | $ 0.03 |
| – per share diluted | $ (0.02) | $ 0.01 | $ 0.04 | $ — | $ 0.01 | $ (0.02) | $ 0.11 | $ 0.03 |

## RISKS AND UNCERTAINTIES

There are business risks associated with the ownership of income-producing properties. Such investments are affected by general economic conditions, local real estate markets, supply and demand for leased premises, competition from other available premises and various other factors.

The value of real property and any improvements thereto may also depend on the credit and financial stability of the tenants. Net income would be adversely affected if a significant number of tenants were to become unable to meet their obligations under their leases or if a significant amount of available space in the properties were not able to be leased on economically favourable lease terms. Upon the expiry of any lease, there can be no assurance that the lease will be renewed or the tenant replaced. The terms of any subsequent lease may be less favourable than the existing lease. In the event of default by a tenant, delays or limitations in enforcing rights as lessor may be experienced and substantial costs in protecting our investment may be incurred. Furthermore, at any time, a tenant may seek the protection of bankruptcy, insolvency or similar laws that could result in the rejection and termination of such tenant's lease and thereby cause a reduction in the cash flow available to us. The ability to rent unleased space in the properties in which we have an interest may be affected by many factors. Costs may be incurred in making improvements or repairs to property required by a new tenant. The failure to rent a significant amount of unleased space on a timely basis or at all would likely have an adverse effect on our financial condition.

Certain significant expenditures, including repairs on the buildings, replacement of equipment, property taxes, maintenance costs, mortgage payments, insurance costs and related charges must be made throughout the period of ownership of real property, regardless of whether the property is producing any income. Although many of these expenditures are recoverable from tenants, the Corporation carries the costs associated with vacant space.

In addition, leases with the federal government are on a semi-gross basis whereby deemed operating costs are increased or decreased annually based on changes in the consumer price index. Actual increases or decreases in operating costs may vary significantly from the amounts recoverable on account thereof in these leases.

We are subject to the risks associated with debt financing, including the risk that existing mortgages will not be able to be refinanced or that the terms of such refinancing will not be as favourable as the terms of existing indebtedness. Our financing may include indebtedness with interest rates based on variable lending rates that will result in fluctuations in our cost of borrowing. If we are unable to meet mortgage payments on any property, losses could be sustained as a result of the mortgagee's exercise of its rights of foreclosure or sale.

As a means to mitigate financial risk, we carefully manage our debt to stagger maturities. As well, we maintain a level of floating rate debt that is prudent under the circumstances. We also attempt to appropriately structure the timing of the

renewal of significant tenant leases in relation to the time at which mortgage indebtedness becomes due for refinancing.

As a means to mitigate the risk associated with geographic concentration, we have diversified our portfolio to include properties in different regional centres in Canada. Within the portfolio, tenant mix is directed towards a variety of private and public sector tenants with strong covenants.

Development of real estate has additional inherent risks, such as real estate market cycles, cost overruns, labour disputes, construction delays and unpredictable general economic conditions. Hurdles to property development include locating and buying attractive development sites, paying the carrying costs of land and development, securing construction financing, obtaining development approvals, marketing and leasing a building in advance of, and during, construction and earning no return during the construction period.

The real estate services business is competitive and continued success depends on our ability to retain contracts, acquire new mandates and to provide a steadily increasing array of new services at a fair price. The potential for termination of contracts exists, due to the investment time horizon of certain clients, wherein a disposition of a property on their part may result in a loss of the management contract. Also, agreements may be terminated in accordance with the provisions of such agreements and may not be renewed upon the expiry of their terms. Most of such agreements have a one-year term and/or are terminable on notice of 90 days or less. The loss of contracts, particularly larger contracts, could have an adverse effect on our financial results.

## OUTLOOK

As we move into 2003, we expect office market conditions to remain challenging through most of 2003. Despite this, we are well positioned to meet this challenge, as the fundamentals of our property portfolio remain stable and we have the capital base to seek out new acquisitions to fuel future growth.

In terms of the O&Y REIT property portfolio, as of February 2003, scheduled portfolio lease expiries for 2003 and current leasing activity are as follows:

| | THREE MONTHS ENDED MAR. 31, 2003 | THREE MONTHS ENDED JUN. 30, 2003 | THREE MONTHS ENDED SEPT. 30, 2003 | THREE MONTHS ENDED DEC. 31, 2003 | YEAR ENDED DEC. 31, 2003 |
|---|---|---|---|---|---|
| Expiries (sq. ft.) | 108,211 | 136,077 | 29,772 | 40,734 | 314,794 |
| Rate per sq. ft. | $ 10.80 | $ 12.99 | $ 13.09 | $ 12.89 | $ 12.23 |
| Committed Renewals/ New Leasing (sq. ft.) | 157,414 | 68,201 | 14,364 | 23,685 | 263,664 |
| Rate per sq. ft. | $ 12.40 | $ 11.71 | $ 11.83 | $ 12.91 | $ 12.24 |

Although O&Y REIT will have positive absorption in the portfolio at rates higher than expiry for the first quarter expiries, there will be some softening in the second quarter, as one of the tenants in 2/24 St. Clair Avenue West, occupying 45,000 square feet, will not renew at expiry. As of February 2003, O&Y REIT has already renewed or leased space equivalent to approximately 84% of its 2003 expiries.

O&Y REIT has a strong balance sheet, with $150 million to $200 million in acquisition capacity, and therefore substantial growth potential that can be realized when conditions are right. Its focus remains on growing the portfolio by continuing to make strategic acquisitions.

O&Y REIT has already made its first acquisitions for 2003. Subsequent to year-end, O&Y REIT announced that it had entered into an agreement to acquire the remaining 50% interest in the Canadian Western Bank Building and Enbridge Tower in Edmonton from its co-owners for $23.25 million. Both buildings are located in Edmonton's central business district. The expected blended yield on the acquisition going in is approximately 11.25% on an unlevered basis and 17% on a levered basis.

At First Canadian Place, the early renewal of BMO Financial Group's 423,000 square feet of leases provides overall stability of cash flows for the building. As of February 2003, scheduled office lease expiries for 2003 and current leasing activity are as follows:

| | THREE MONTHS ENDED MAR. 31, 2003 | THREE MONTHS ENDED JUN. 30, 2003 | THREE MONTHS ENDED SEPT. 30, 2003 | THREE MONTHS ENDED DEC. 31, 2003 | YEAR ENDED DEC. 31, 2003 |
|---|---|---|---|---|---|
| Expiries (sq. ft.) | 37,546 | 19,181 | 13,638 | 46,323 | 116,688 |
| Rate per sq. ft. | $ 9.67 | $ 32.43 | $ 18.66 | $ 22.50 | $ 19.55 |
| Committed Renewals/ New Leasing (sq. ft.) | 7,573 | 6,000 | — | — | 13,573 |
| Rate per sq. ft. | $ 28.53 | $ 33.50 | — | — | $ 30.73 |

On the development front, completing the lease-up of the Maritime Life Tower is a significant priority in 2003, and we are continuing to market this space aggressively. As we noted above, leasing activity has been sluggish pending a return of corporate confidence. However, our strong financial position provides us with the ability to manage our business through this challenging environment.

O&Y Enterprise's new focus and structure positions it to operate efficiently while providing the highest level of service to its clients across the country. O&Y Enterprise will continue to look for growth opportunities across its various business lines.

We remain focused on the strategies that delivered solid results in the challenging conditions prevailing in 2002, and will continue to follow our disciplined investment philosophy moving forward.

**Cautionary statement regarding forward-looking statements**

This Management's Discussion and Analysis contains forward-looking statements relating to our operations and the environment in which we operate, which are based on our expectations, estimates, forecasts and projections. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to control or predict. Therefore, actual outcomes and results may differ materially from those expressed in these forward-looking statements. Readers, therefore, should not place undue reliance on any such forward-looking statements. Further, a forward-looking statement speaks only as of the date on which such statement is made. We undertake no obligation to publicly update any such statement, to reflect new information or the occurrence of future events or circumstances.

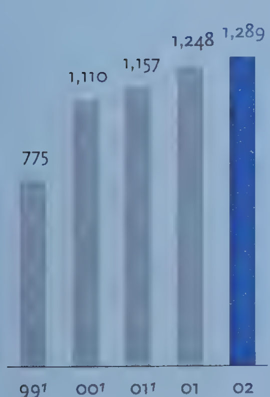
# FINANCIAL RESULTS

# O&Y PROPERTIES CORPORATION

## 2002 FINANCIAL HIGHLIGHTS

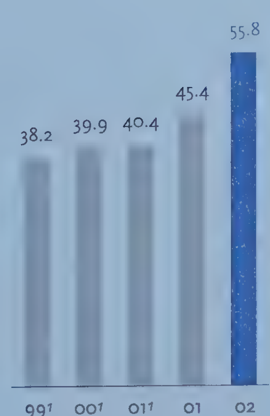
| *(in thousands of dollars except per share amounts)* | TWELVE MONTHS ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| Assets | $ 1,288,548 | $ 1,248,570 |
| Revenues | $ 291,735 | $ 265,268 |
| Funds from operations | $ 55,798 | $ 45,359 |
| – per share basic | $ 1.23 | $ 0.95 |
| – per share diluted | $ 1.09 | $ 0.86 |
| Net income | $ 6,320 | $ 10,239 |
| – per share basic | $ 0.04 | $ 0.14 |
| – per share diluted | $ 0.04 | $ 0.14 |
| Net rental income | $ 99,074 | $ 86,657 |
| Real estate services income | $ 8,958 | $ 7,698 |
| Debt-to-equity ratio | 1.43:1 | 1.31:1 |
| Number of shares (basic) (000s) | 40,134 | 40,669 |
| Shareholders' equity | $ 408,763 | $ 414,680 |

**TOTAL ASSETS**



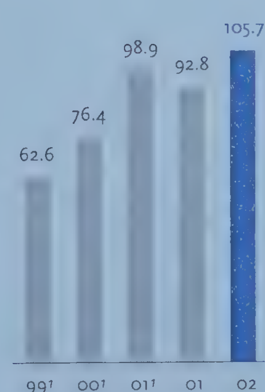

*(in millions of dollars)*

**FUNDS FROM OPERATIONS**




*(in millions of dollars)*

**RENTAL AND REAL ESTATE SERVICES INCOME**




*(in millions of dollars)*

*(1) for the twelve months ended January 31*

The consolidated financial statements and management's discussion and analysis contained in this annual report are the responsibility of the management of O&Y Properties Corporation. To fulfill this responsibility, the Company maintains a system of internal controls to ensure that its reporting practices and accounting and administrative procedures are appropriate, and provide assurance that relevant and reliable financial information is produced. The consolidated financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based on management's best judgment in the circumstances. The financial information presented throughout this annual report is consistent with the information contained in the consolidated financial statements.

Deloitte & Touche LLP, the independent auditors appointed by the shareholders, have audited the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the shareholders their opinion on the consolidated financial statements. Their report as auditors is set out on the following page.

The consolidated financial statements have been further examined by the Board of Directors and by its Audit Committee which meets regularly with the auditors and management to review the activities of each. The Audit Committee, which is comprised of three directors who are not officers of the Company, reports to the Board of Directors.

Philip Reichmann
*Chief Executive Officer*

Raghunath Davloor
*Chief Financial Officer*

February 28, 2003

# AUDITORS' REPORT TO SHAREHOLDERS

To the Shareholders of O&Y Properties Corporation:

We have audited the consolidated balance sheets of O&Y Properties Corporation as at December 31, 2002 and December 31, 2001, and the consolidated statements of earnings and retained earnings, funds from operations and cash flow for the year ended December 31, 2002 and the eleven-month period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and December 31, 2001, and the results of its operations and its cash flow for the periods then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
*Toronto, Canada*

February 28, 2003 (except as to Note 22, which is as of April 1, 2003)

# CONSOLIDATED BALANCE SHEETS

| (in thousands of dollars) | NOTES | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|---|
| **ASSETS** | | | |
| Rental properties | 3 | $ 1,060,722 | $ 1,008,308 |
| Properties under development | 4 | 104,363 | 62,016 |
| Land held for development | 5 | 14,725 | 5,687 |
| Goodwill and intangible assets | 2 | 19,246 | 28,547 |
| Amounts receivable | | 17,321 | 11,990 |
| Deferred costs and other assets | 6 | 43,426 | 31,957 |
| Cash, cash equivalents and short-term investments | 7 | 28,745 | 100,065 |
| | | $ 1,288,548 | $ 1,248,570 |
| **LIABILITIES** | | | |
| Secured debt | 8 | $ 575,164 | $ 525,265 |
| Accounts payable and accrued liabilities | | 43,530 | 46,505 |
| Other liabilities | 9 | 31,566 | 20,724 |
| Income taxes payable | | — | 22,882 |
| Future income taxes | 10 | 54,123 | 57,663 |
| Debentures, notes and preferred shares, liability component | 11 | 10,486 | 16,779 |
| | | 714,869 | 689,818 |
| Interest of others in O&Y REIT | | 164,916 | 144,072 |
| **SHAREHOLDERS' EQUITY** | | | |
| Debentures, notes and preferred shares, equity component | 11 | 114,672 | 112,202 |
| Common shares | 12 | 229,185 | 232,237 |
| Retained earnings | | 62,547 | 69,154 |
| Contributed surplus | 15 | 2,359 | 1,087 |
| | | 408,763 | 414,680 |
| | | $ 1,288,548 | $ 1,248,570 |

See accompanying notes to consolidated financial statements.

On behalf of the Board:

T Donath

Tibor Donath

*Director*

Maureen Sabia

Maureen Sabia

*Director*

## CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

| *(in thousands of dollars except per share amounts)* | NOTES | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|---|
| **REVENUES** | | | |
| Rental property | | $ 237,953 | $ 208,336 |
| Real estate services | | 53,782 | 56,932 |
| | | 291,735 | 265,268 |
| **EXPENSES** | | | |
| Rental property operating expenses and taxes | | 112,538 | 98,076 |
| Ground rent and entitlements | 14 | 23,939 | 21,811 |
| Real estate services | | 49,557 | 52,617 |
| | | 186,034 | 172,504 |
| Rental and real estate services income | | 105,701 | 92,764 |
| Financing expense | 8 | 34,960 | 35,057 |
| Corporate expense | | 10,120 | 8,328 |
| System implementation costs | | 3,130 | 250 |
| Depreciation of rental properties | 3 | 15,543 | 15,999 |
| Amortization of real estate services contracts | 2 | 974 | 6,907 |
| Other depreciation and amortization | 6 | 10,727 | 7,087 |
| | | 75,454 | 73,628 |
| Income before the undernoted items | | 30,247 | 19,136 |
| Interest of others in O&Y REIT | | (15,244) | (6,993) |
| Other items | 15 | (7,801) | (3,365) |
| | | (23,045) | (10,358) |
| Income before taxation | | 7,202 | 8,778 |
| Current income tax recovery (expense) | | 6,380 | (13,385) |
| Future income tax (expense) recovery | | (7,262) | 14,846 |
| | 10 | (882) | 1,461 |
| Net income for the period | | $ 6,320 | $ 10,239 |
| Retained earnings, beginning of the period | | 69,154 | 63,372 |
| Dividends | | (8,077) | — |
| Accretion on equity component of debentures, notes and preferred shares, net of tax | | (4,850) | (4,457) |
| Retained earnings, end of period | | $ 62,547 | $ 69,154 |
| **EARNINGS PER COMMON SHARE** | 13 | | |
| Basic | | $ 0.04 | $ 0.14 |
| Diluted | | $ 0.04 | $ 0.14 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF FUNDS FROM OPERATIONS

| *Inflows (outflows)* *(in thousands of dollars except per share amounts)* | NOTES | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|---|
| Net income for the period | | $ 6,320 | $ 10,239 |
| **NON-CASH ITEMS:** | | | |
| Depreciation and amortization of tenant inducements, leasing costs, income subsidy and real estate services contracts | | 24,768 | 27,988 |
| Future income tax expense (recovery) | | 7,262 | (14,846) |
| Interest of others in O&Y REIT | | 15,244 | 6,993 |
| | | 47,274 | 20,135 |
| **NON-OPERATING ITEMS, NET OF CURRENT TAX:** | 15 | | |
| Loss on repurchase of convertible unsecured subordinated debentures, net of current tax benefit of $417 (eleven months ended December 31, 2001 – $240) | | 667 | 445 |
| Restructuring charge, net of current tax benefit of $2,983 (eleven months ended December 31, 2001 – $265) | | 3,993 | 4,185 |
| Non-operating current tax adjustment | | (2,298) | — |
| Gain on disposition of rental properties, net of current tax expense of $ nil (eleven months ended December 31, 2001 – $12,125) | | — | 10,355 |
| Gain on repurchase of unsecured debentures of a subsidiary, net of current tax expense of $101 | | (158) | — |
| | | 2,204 | 14,985 |
| Funds from operations | | $ 55,798 | $ 45,359 |
| **FUNDS FROM OPERATIONS PER COMMON SHARE** | 13 | | |
| Basic | | $ 1.23 | $ 0.95 |
| Diluted | | $ 1.09 | $ 0.86 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOW

| *Inflows (outflows)* *(in thousands of dollars)* | NOTES | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Funds from operations | | $ 55,798 | $ 45,359 |
| Amortization of deferred financing costs and recoverable expenditures | 6 | 2,476 | 2,005 |
| Net change in operating working capital | | (2,809) | 23,194 |
| Current tax expense on other items | 15 | 5,597 | (11,620) |
| Restructuring charge | 15 | (6,976) | (4,450) |
| Tenant inducements and leasing costs | | (7,496) | (5,482) |
| Recoverable expenditures | | (5,323) | (2,988) |
| | | 41,267 | 46,018 |
| Payment of income taxes | | (27,826) | (5,781) |
| Cash provided by operating activities | | 13,441 | 40,237 |
| **FINANCING ACTIVITIES** | | | |
| Construction financing | | 45,847 | 5,180 |
| Regular principal repayments | | (11,275) | (15,015) |
| Debt repaid from proceeds of asset dispositions | | — | (41,285) |
| Other repayments of debt | | (17,543) | (30,885) |
| Increase (decrease) in bank loan | | 1,400 | 28,600 |
| Debentures, notes and preferred share payments | | (6,876) | (6,505) |
| Repurchase of common shares for cancellation | | (3,346) | (12,264) |
| Common shares issued on exercise of options | | 294 | — |
| Repurchase of convertible unsecured subordinated debentures | | (4,434) | (3,115) |
| Dividends paid | | (6,072) | — |
| Proceeds from equity offering of subsidiary, net | | 24,325 | — |
| Distribution paid to other unitholders in O&Y REIT | | (17,768) | (8,148) |
| Debt issue and retirement costs | | — | (2,296) |
| Cash provided by (used in) financing activities | | 4,552 | (85,733) |
| **INVESTMENT ACTIVITIES** | | | |
| Maturities (purchase) of short-term investments | | 44,495 | (44,495) |
| Expenditures on rental properties | | (3,571) | (6,057) |
| Expenditures on furniture, fixtures and equipment | | (5,425) | (3,349) |
| Expenditures on properties under development | | (49,523) | (21,600) |
| Expenditures on land held for development | | (1,903) | (564) |
| Proceeds from equity offering of subsidiary, net | | — | 143,438 |
| Land transfer tax and other costs incurred on transfer of properties to O&Y REIT | | — | (5,415) |
| Acquisition of rental properties, net of mortgage assumed | 3 | (23,323) | — |
| Acquisition of land held for development | 5 | (4,534) | — |
| Purchase of additional units in O&Y REIT | | (933) | — |
| Other | | (101) | 257 |
| Cash provided by (used in) investment activities | | (44,818) | 62,215 |
| Inflows (outflows) of cash and cash equivalents during the period | | (26,825) | 16,719 |
| Cash and cash equivalents – beginning of period | | 55,570 | 38,851 |
| Cash and cash equivalents – end of period | 7 | $ 28,745 | $ 55,570 |
| Supplementary cash flow information | | | |
| Cash paid for interest | | $ 47,269 | $ 40,338 |

See accompanying notes to consolidated financial statements.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

## 1. SIGNIFICANT ACCOUNTING POLICIES

### (a) General

O&Y Properties Corporation (the "Company" or "OYPC") is incorporated under the Business Corporations Act (Ontario). The Company's accounting policies and standards of financial disclosure are in accordance with Canadian generally accepted accounting principles and are also in accordance with the recommendations of the Canadian Institute of Public and Private Real Estate Companies ("CIPPREC"), of which the Company is a member.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual amounts could differ from these estimates.

During the eleven months ended December 31, 2001, the Company changed its fiscal year end from January 31 to December 31. Accordingly the comparative figures presented in the consolidated statements of earnings and retained earnings, funds from operations and cash flow for the period ended December 31, 2001 represent an eleven-month period.

### (b) Consolidation

The consolidated financial statements include the accounts of O&Y Properties Corporation, its subsidiaries and joint ventures, of which the major ones are:

| ENTITIES | INTEREST HELD ON DECEMBER 31, 2002 | ACCOUNTING METHOD |
|---|---|---|
| O&Y Properties Inc. | 100% | Consolidation |
| O&Y FPT Inc. | 100% | Consolidation |
| O&Y Properties (Alberta) Inc. | 100% | Consolidation |
| O&Y Real Estate Investment Trust | 50.3% | Consolidation |
| O&Y CB Richard Ellis Facilities Management | 60% | Proportionate consolidation |
| Purdy's Wharf | 50% | Proportionate consolidation |
| Enbridge Tower | 50% | Proportionate consolidation |
| Canadian Western Bank Building | 50% | Proportionate consolidation |

The interest of other O&Y Real Estate Investment Trust ("O&Y REIT") unitholders, other than O&Y Properties Corporation, in O&Y REIT are presented in these consolidated financial statements as "Interest of others in O&Y REIT".

On March 26, 2002, O&Y REIT completed a private placement of 4,619,465 units at $10.85 per unit, for total proceeds of $49,295,000, net of issue costs. O&Y Properties Corporation exercised its maintenance right by subscribing to 2,314,465 units representing 50.1% of the issue. The amount recorded in "Interest of others in O&Y REIT" on the balance sheet has been increased by the amount of the issue subscribed to by parties other than O&Y Properties Corporation and affiliates.

### (c) Rental Properties

Rental properties include land, buildings and improvements.

Rental properties are carried at the lower of cost less accumulated depreciation and amortization and estimated net recoverable amount. The net recoverable amount for each of the Company's rental properties represents the undiscounted estimated future cash flow expected to be received from the ongoing use of the property plus its residual worth.

Depreciation on buildings and improvements is provided using the sinking fund method in annual amounts increasing at the rate of 5% compounded annually, which is designed to fully amortize the cost of the buildings and improvements over 30 to 60 years.

### (d) Properties Under Development

Properties under development consists of office buildings under construction, which are recorded at the lower of cost, including predevelopment expenditures, and estimated net recoverable amount.

### (e) Land Held for Development

Land held for development is recorded at the lower of cost plus applicable carrying costs and estimated net realizable value.

### (f) Revenue Recognition

Rental property revenues include rents from tenants under leases, percentage participation rents, property tax and operating cost recoveries, lease cancellation fees, leasing concessions, parking income and incidental income. Percentage participation rent is recognized after the minimum sales level has been achieved in accordance with each lease. All other rental revenue is recognized in accordance with each lease.

For properties under development, revenue is recognized once a property is deemed to be completed. Completion is deemed to occur once a break-even point in operating cash flow after debt servicing is attained, subject to a reasonable maximum period of time or level of occupancy. Prior to achieving this level of cash flow, properties are classified as properties under development and revenue therefrom is treated as a deduction from the development cost.

Revenue from a real estate sale is recognized once all material conditions have been satisfied and collection of the sales proceeds is reasonably assured.

Real estate services revenue from managing and leasing commercial real estate is recorded on an accrual basis when earned. Design and construction fees forming part of real estate services revenue is recognized on a percentage of completion basis.

### (g) Real Estate Services Contracts

Real estate services contracts are recorded at the lower of cost net of accumulated amortization and estimated net recoverable amount. Real estate services contracts are amortized on a straight-line basis over 8 years.

### (h) Deferred Costs

Tenant inducements, leasing costs, and financing costs are amortized on a straight-line basis over the terms of the leases or debt to which they relate. Recoverable capital expenditures are amortized over their estimated useful lives of up to 10 years.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

(i) Capitalization of Costs

The cost of land held for development and properties under development includes interest on both specific and general debt, property taxes and general and administrative expenses incurred directly in connection with the acquisition, development and redevelopment of properties. Revenues relating specifically to such properties are treated as a reduction of costs.

(j) Cash, Cash Equivalents and Short-Term Investments

Cash and cash equivalents which consist primarily of highly liquid bank term deposits and commercial paper are restricted to investments which have an original maturity of three months or less at the time of purchase. Short-term investments consists primarily of term deposits and bonds with original maturities in excess of three months. Cash, cash equivalents and short-term investments are recorded at cost plus accrued interest, which approximates market value.

(k) Stock-Based Compensation Plans

The Company has stock-based compensation plans which are described in Note 12. No compensation expense is recognized when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital. Compensation expense is recognized for the Company's contributions to the Deferred Share Unit Plan. Effective January 1, 2002, the Company has adopted new disclosure recommendations, as described in Note 2(b).

(l) Pensions

The Company has a defined contribution pension plan. The Company contributions required under the plan are recorded as an expense on an accrual basis. Contributions in respect of the year ended December 31, 2002 were $962,000 ($850,000 – eleven months ended December 31, 2001).

## 2. CHANGES IN ACCOUNTING POLICIES

(a) Goodwill and Intangible Assets

Effective January 1, 2002, the Company adopted and applied prospectively the new recommendations of the Canadian Institute of Chartered Accountants regarding goodwill and other intangible assets (the "new standard"). Under the new standard, goodwill and other intangibles with an indefinite life are not amortized but are tested for impairment annually, as well as within 6 months of adopting the new standard.

As a result of the adoption of this new standard, management undertook a review of the allocation of the amount shown as real estate services contracts in the Company's financial statements as at December 31, 2001 as it relates to real estate services businesses acquired in prior years. It has been determined, by reference to the estimated fair value at the date of acquisition, that $24.3 million represents unamortized goodwill and $4.3 million represents unamortized real estate services contracts on that date. The portion allocated to goodwill has an indefinite life and, therefore, will no longer be amortized in accordance with the new standard. The portion allocated to real estate services contracts will continue to be amortized over its remaining estimated useful life.

As a result of the application of this new standard, the difference between the carrying value of the goodwill and the amounts deductible in future periods in calculating taxable income now are considered a permanent difference between accounting income and taxable income. Therefore, the Company's future income tax liability has been reduced by $8.3 million with an offsetting reduction in the goodwill amount.

The following table details changes in the balance sheet accounts since December 31, 2001 in connection with the application of this new standard:

| | REAL ESTATE SERVICE CONTRACTS | GOODWILL | TOTAL |
|---|---|---|---|
| Balance, December 31, 2001 | $ 28,547 | $ — | $ 28,547 |
| Impact of adoption of new standard | (24,265) | 24,265 | — |
| Future income taxes | — | (8,327) | (8,327) |
| Amortization for the year ended December 31, 2002 | (974) | — | (974) |
| Balance, December 31, 2002 | $ 3,308 | $ 15,938 | $ 19,246 |

The following table details the impact on net income and earnings per share for the eleven months ended December 31, 2001 had the portion allocated to goodwill not been amortized in the previous reporting periods.

| | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|
| Net income as reported | $ 10,239 |
| Add: | |
| Amortization of goodwill | 5,871 |
| Less: | |
| Future income tax reduction | (2,407) |
| Adjusted net income | $ 13,703 |
| Adjusted per share amounts: | |
| Basic earnings per share | $ 0.22 |
| Diluted earnings per share | $ 0.22 |

There would be no change to the previously reported funds from operations or funds from operations per share amounts.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

(b) Stock-Based Compensation

The Company has adopted the new recommendations of the Canadian Institute of Chartered Accountants regarding stock-based compensation. These recommendations are consistent with the Company's existing accounting practices, except that the Company, by way of note disclosure, now discloses the pro forma impact on compensation expense and net income as if the fair value of stock options granted on or after January 1, 2002 was recorded as an expense in the income statement. The pro forma disclosure applies only to the effect of awards granted after January 1, 2002 in accordance with the new recommendations. These disclosures are included in Note 12.

## 3. RENTAL PROPERTIES

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Land | $ 202,339 | $ 191,401 |
| Buildings and improvements | 902,378 | 845,359 |
| | 1,104,717 | 1,036,760 |
| Less accumulated depreciation | (43,995) | (28,452) |
| | $ 1,060,722 | $ 1,008,308 |

In March 2002, O&Y REIT acquired a 50% interest in two rental properties in Edmonton, Alberta from an unrelated party. The purchase price was $22.1 million. After mortgages of $12.7 million and working capital adjustments, the net cash outlay for the transaction was $7.7 million.

In June 2002, O&Y REIT purchased 1035 – 7th Avenue S.W., Calgary, previously a property under development, from a subsidiary of OYPC. 1035 – 7th Avenue S.W. is now classified with rental properties as the redevelopment is complete. The property's revenues and operating expenses are included in the statement of earnings from June 1, 2002.

In October, 2002, O&Y REIT completed the acquisition of the remaining 50% interest in the Altius Centre, a rental property in Calgary, Alberta, for $32.5 million from an unrelated party. After a mortgage assumed of $16.2 million and working capital adjustments, the net cash outlay for the transaction was $15.6 million.

## 4. PROPERTIES UNDER DEVELOPMENT

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Land | $ 24,005 | $ 24,005 |
| Buildings and improvements | 80,358 | 38,011 |
| | $ 104,363 | $ 62,016 |
| The change during the period consisted of the following: | | |
| Transfers in (out) | $ (9,769) | $ 7,442 |
| Development costs | 45,718 | 24,398 |
| Financing | 5,400 | 2,515 |
| General and administrative | 998 | 854 |
| | $ 42,347 | $ 35,209 |

At December 31, 2002 the property under development consisted of the Maritime Life Tower only. At December 31, 2001, the balance included 1035 – 7th Avenue S.W., Calgary, which was transferred to rental properties during 2002.

The Maritime Life Tower will be reclassified to rental properties no later than June 30, 2004, or such earlier date upon attainment of 75% occupancy or break-even cash flow after debt servicing, in accordance with the Company's accounting policy regarding revenue recognition.

## 5. LAND HELD FOR DEVELOPMENT

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Land held for development | $ 14,725 | $ 5,687 |
| The change during the period consisted of the following: | | |
| Financing | $ 759 | $ 252 |
| Realty taxes, net | 198 | 132 |
| Net operating and pre-development costs | 947 | 204 |
| Acquisitions | 7,134 | — |
| Transfers in | — | 900 |
| | $ 9,038 | $ 1,488 |

In May 2002, the Company purchased the remaining 50% interest in Place de Ville III, a development property in Ottawa, from its two joint venture partners, one of which is a minority limited partner in RHHI Limited Partnership ("RHHI LP"). RHHI LP owns approximately 45.5% of the common shares of the Company. The total purchase price of $7.1 million was satisfied through the assumption of a mortgage of $2.6 million and $4.5 million in cash.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

## 6. DEFERRED COSTS AND OTHER ASSETS

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Tenant inducements and leasing costs | $ 22,332 | $ 14,836 |
| Recoverable expenditures | 12,835 | 7,512 |
| Deferred financing costs | 10,200 | 10,118 |
| Less accumulated amortization | (16,082) | (9,371) |
| | 29,285 | 23,095 |
| Furniture, fixtures and equipment, net of accumulated depreciation of $7,044 (December 31, 2001 – $5,265) | 9,388 | 7,177 |
| Prepaid expenses and other | 4,753 | 1,685 |
| | $ 43,426 | $ 31,957 |

Other depreciation and amortization consists of the following:

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| Amortization of tenant inducements and leasing costs | $ 4,235 | $ 2,469 |
| Amortization of recoverable expenditures | 824 | 616 |
| Amortization of deferred financing costs | 1,652 | 1,389 |
| Amortization of the income subsidy *(Note 9)* | 802 | 300 |
| Depreciation and amortization of furniture, fixtures and equipment, and other items | 3,214 | 2,313 |
| | $ 10,727 | $ 7,087 |

During the year $1,435,000 of fully depreciated furniture, fixtures and equipment was written off.

## 7. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Cash and cash equivalents | $ 28,745 | $ 55,570 |
| Short-term investments | — | 44,495 |
| | $ 28,745 | $ 100,065 |

Included in cash and cash equivalents at December 31, 2002 is $11.8 million (December 31, 2001 – $13.9 million) held, pursuant to: the terms of joint venture arrangements, the First Canadian Place Land Lease, and various debt agreements, including a trust indenture governing an issue of bonds. Also included in cash and cash equivalents is $6.1 million (December 31, 2001 – $7.3 million) held by O&Y REIT.

## 8. SECURED DEBT

| | Interest rates at December 31, 2002: Range % – % | Weighted average % | Maturing in years ending December 31 | Total December 31, 2002 |
|---|---|---|---|---|
| **O&Y REIT:** | | | | |
| Fixed rate mortgages | 5.98% – 7.81% | 7.23% | 2003 – 2011 | $ 209,709 |
| Bank loan | B.A. + 1.85% OR PRIME + 0.85% | 4.70% | 2003 | 30,000 |
| | | | | 239,709 |
| **O&Y FPT INC.:** | | | | |
| First Mortgage Bonds | 8.06% | 8.06% | 2009 | 284,428 |
| **OTHER SECURED DEBT:** | | | | |
| Construction financing | PRIME + 1.5% | 6.0% | 2004 | 51,027 |
| | | | | $ 575,164 |

| | Interest rates at December 31, 2001: Range % – % | Weighted average % | Maturing in years ending December 31 | Total December 31, 2001 |
|---|---|---|---|---|
| **O&Y REIT:** | | | | |
| Fixed rate mortgages | 5.98% – 7.81% | 7.33% | 2002 – 2011 | $ 198,847 |
| Bank loan | B.A. + 1.85% OR PRIME + 0.85% | 4.01% | 2003 | 28,600 |
| | | | | 227,447 |
| **O&Y FPT INC.:** | | | | |
| First Mortgage Bonds | 8.06% | 8.06% | 2009 | 290,038 |
| **OTHER SECURED DEBT:** | | | | |
| Construction financing | PRIME + 1.5% | 5.5% | 2004 | 5,180 |
| Mortgage on land held for development | 10.00% | 10.00% | 2002 | 2,600 |
| | | | | $ 525,265 |

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

Fixed rate mortgages of O&Y REIT are due as follows:

| *Year ending December 31* | PRINCIPAL INSTALLMENT PAYMENTS | BALANCE MATURING | TOTAL | WEIGHTED AVERAGE INTEREST RATE ON DEBT MATURING |
|---|---|---|---|---|
| 2003 | $ 11,159 | $ 34,025 | $ 45,184 | 6.62% |
| 2004 | 11,697 | — | 11,697 | |
| 2005 | 6,348 | 57,071 | 63,419 | 7.61% |
| 2006 | 4,294 | 6,059 | 10,353 | 5.98% |
| 2007 | 4,462 | — | 4,462 | |
| Thereafter | 6,757 | 67,837 | 74,594 | 7.25% |
| | $ 44,717 | $ 164,992 | $ 209,709 | 7.23% |

O&Y REIT has an $80 million operating/acquisition facility available with two Canadian Chartered Banks which matures in August 2003. The facility is secured by a pool of rental property assets. Interest is at the rate of Bankers' Acceptances ("BA") plus 1.85% (for BA loans) or prime plus 0.85% (for prime-based loans). O&Y REIT pays a standby fee of 0.4% per annum on the undrawn amount of the facility. The amount outstanding at December 31, 2002 consists of BA loans of $30 million (December 31, 2001 – $28.6 million). The weighted average interest rate on the amount outstanding at December 31, 2002 on the BA loans was 4.7% (December 31, 2001 – 4.0%). With the current properties being used to secure this facility, $74.6 million is the maximum amount available to draw upon at December 31, 2002.

O&Y FPT Inc. first mortgage bonds are secured under a bond indenture by a fixed and floating charge and security interest on all assets of O&Y FPT Inc., including its interest in First Canadian Place ("FCP"). The first mortgage bonds are due as follows:

| *Year ending December 31* | PRINCIPAL INSTALLMENT PAYMENTS | BALANCE MATURING | TOTAL |
|---|---|---|---|
| 2003 | $ 6,064 | $ — | $ 6,064 |
| 2004 | 6,563 | — | 6,563 |
| 2005 | 7,102 | — | 7,102 |
| 2006 | 7,686 | — | 7,686 |
| 2007 | 8,318 | — | 8,318 |
| Thereafter | 18,738 | 229,957 | 248,695 |
| | $ 54,471 | $ 229,957 | $ 284,428 |

The Company has an $82.7 million construction financing facility secured by the Maritime Life Tower development project. Interest is payable monthly at prime plus 1.5% and the facility matures in June 2004. The Company has the option to pre-pay the amounts borrowed under the facility at any time.

Substantially all of the Company's real estate assets have been pledged as security under the various debt agreements.

Financing expense is recorded net of the following items:

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| Interest income on cash, cash equivalents and short-term investments | $ 1,145 | $ 2,130 |
| Interest capitalized to properties under development and land held for development | 6,159 | 2,767 |
| | $ 7,304 | $ 4,897 |

## 9. OTHER LIABILITIES

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Restructuring accrual balance *(Note 15(d))* | $ 7,680 | $ 3,817 |
| PDV II Income subsidy (below) | 6,608 | 5,806 |
| Equipment leases (below) | 4,936 | 4,335 |
| Tenant inducements and leasing costs | 3,790 | 1,173 |
| Construction holdbacks on property under development | 5,663 | 1,667 |
| Unsecured indebtedness of a subsidiary (below) | 2,889 | 3,926 |
| | $ 31,566 | $ 20,724 |

### The PDV II Income Subsidy Agreement

In connection with O&Y REIT's initial public offering (Note 15(c)), O&Y Properties Inc. ("OYPI") agreed to provide O&Y REIT with an income subsidy to offset the contractual reduction in revenue of $6.97 per square foot per annum commencing on November 1, 2003, in connection with the federal government's long-term lease of approximately 577,000 square feet expiring on October 31, 2008 at Place de Ville II ("PDV II") located in Ottawa. The income subsidy terminates on October 31, 2008 or earlier in the event that the amount of the income subsidy has reduced to zero as a result of an amendment, renewal, extension or replacement of the lease by O&Y REIT. The amount recorded in these consolidated financial statements as a liability represents the present value of this obligation, adjusted for the Company's ownership interest in O&Y REIT. The increase in the income subsidy is reflected as amortization expense (Note 6).

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

### Equipment Leases

The equipment leases are for computers and related equipment. They bear interest at rates between 5.1% and 11.5% and expire between 2003 and 2006.

The repayment schedule is as follows:

| | PRINCIPAL | INTEREST | TOTAL |
|---|---|---|---|
| 2003 | $ 1,966 | $ 341 | $ 2,307 |
| 2004 | 1,825 | 177 | 2,002 |
| 2005 | 718 | 59 | 777 |
| 2006 | 427 | 18 | 445 |
| | $ 4,936 | $ 595 | $ 5,531 |

### Unsecured Indebtedness

Unsecured debt is comprised of $1,745,000 (December 31, 2001 – $2,782,000) of bonds and $1,144,000 (December 31, 2001 – $1,144,000) of debentures. The bonds bear interest payable semi-annually at 9.22% per annum and mature in 2005. During the year, the Company repurchased $1,037,000 par value of the unsecured bonds resulting in a pre-tax gain of $259,000 (Note 15(b)). The debentures bear interest payable semi-annually, in arrears, at 11% per annum and mature in 2015. They are direct, unsecured obligations of the Company and rank subordinate to all other present and future indebtedness of the Company.

## 10. INCOME TAXES

(a) The net future income tax liabilities of the Company consist of the following:

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Future income tax liabilities related to differences in tax and book values of rental properties and other assets, net | $ 71,283 | $ 78,902 |
| Future income tax assets related to: | | |
| (i) Non-capital losses | (7,014) | (8,289) |
| (ii) Debt redemption and share issuance costs | (10,146) | (12,950) |
| | $ 54,123 | $ 57,663 |

(b) A reconciliation between the income tax computed on pre-tax income at statutory rates and the actual provision, is as follows:

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| Income tax benefit (expense) based on combined Canadian federal and provincial income tax rate of 38.62% (December 31, 2001 – 41.9%) | $ (2,781) | $ (3,678) |
| Decrease (increase) in income tax expense resulting from: | — | |
| Reduction in future income tax rates | 1,044 | 15,514 |
| Non-taxable portion of capital gains | 172 | 1,463 |
| Changes in future income tax liability arising from the formation of O&Y REIT | — | (11,041) |
| Large corporations tax | (1,637) | (611) |
| Adjustment to capital gains reserve | 2,298 | — |
| Other, net | 22 | (186) |
| | $ (882) | $ 1,461 |

## 11. DEBENTURES, NOTES AND PREFERRED SHARES

| *December 31, 2002* | LIABILITY | EQUITY | TOTAL |
|---|---|---|---|
| Convertible unsecured subordinated debentures | $ 2,582 | $ 90,626 | $ 93,208 |
| Series 1 convertible preferred shares | 2,955 | 13,306 | 16,261 |
| Exchangeable notes of a subsidiary | 1,545 | 4,957 | 6,502 |
| Series A convertible debentures | 1,804 | 5,783 | 7,587 |
| Series 2 redeemable preferred shares of a subsidiary | 1,600 | — | 1,600 |
| | $ 10,486 | $ 114,672 | $ 125,158 |

| *December 31, 2001* | LIABILITY | EQUITY | TOTAL |
|---|---|---|---|
| Convertible unsecured subordinated debentures | $ 7,902 | $ 89,526 | $ 97,428 |
| Series 1 convertible preferred shares | 3,425 | 12,618 | 16,043 |
| Exchangeable notes of a subsidiary | 1,778 | 4,642 | 6,420 |
| Series A convertible debentures | 2,074 | 5,416 | 7,490 |
| Series 2 redeemable preferred shares of a subsidiary | 1,600 | — | 1,600 |
| | $ 16,779 | $ 112,202 | $ 128,981 |

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

The Company is authorized to issue an unlimited number of preferred shares. The preferred shares are non-voting, issuable in series, each series ranking equally and are senior to the common shares.

On June 30, 1998, the Company issued $100 million of 5.9% convertible unsecured subordinated debentures (the "Subordinated Debentures") due June 30, 2008. The Subordinated Debentures are convertible into common shares at $11.50 per common share, are redeemable at the option of the Company in cash or shares on or after June 30, 2003 and are also redeemable at the option of the Company after June 30, 2002 provided that the weighted average closing price of the Company's common shares during the 20 consecutive trading days ending five trading days preceding the date on which the notice of redemption is given is not less than $14.375 per share. As at December 31, 2002, $90,718,000 of face value of the convertible debentures were outstanding, after repurchases during the year. (See Note 15(a))

The aggregate face amount of the 4.44% Series 1 convertible preferred shares (the "Preferred Shares") is $15 million (600,000 shares). The Preferred Shares are required to be redeemed on September 25, 2007, convertible into common shares of the Company at $8.25 at the option of the holder and redeemable under certain conditions at the option of the Company after September 25, 2002 (or after September 25, 2000 if the market price of the Company's common shares exceeds $10.31) in cash or common shares.

The aggregate original principal amount of the notes of a subsidiary (which are exchangeable into 6% convertible debentures or common shares of the Company) (the "Notes") was $13 million. $7 million of these Notes have been converted into $7 million of Series A convertible debentures (the "Convertible Debentures") of the Company. The Notes and Convertible Debentures are redeemable and convertible on substantially the same terms as the Preferred Shares.

The Preferred Shares, Notes, Convertible Debentures and Subordinated Debentures may be settled at the issuer's option in cash or its own common shares. Accordingly, the obligation to make cash payments on account of interest is reflected as a liability (at the net original present value of such payments) with the remaining amount, being the present value of the principal portion of the security, reflected as equity. The fair value as at the date of issuance of the holder's option to convert is also reflected as equity.

The liability component of the above financial instruments is increased each year to reflect the time value of money and reduced by cash payments of interest. The accretion is reflected as financing expense in the consolidated statement of earnings and retained earnings. The ongoing accretion of the equity component, which will increase this component from its initial carrying amount to the stated principal amount of the above financial instruments, is reflected as a charge to retained earnings, net of income taxes. In computing earnings per common share, these charges to retained earnings are deducted from earnings available to common shareholders.

The 1,600 outstanding Series 2 redeemable preferred shares of a subsidiary are non-dividend bearing and are redeemable at the option of the Company at any time and at the option of the holder on or after March 25, 2005.

## 12. COMMON SHARES

### (a) Common Shares

The Company is authorized to issue an unlimited number of common shares. The common shares entitle the holder to one vote per share.

The following common share transactions occurred during the past two fiscal years:

| | NUMBER OF SHARES (000s) | DOLLARS (000s) |
|---|---|---|
| Outstanding as at January 31, 2001 | 42,603 | $ 242,501 |
| Issuance for acquisition of Enterprise Group of Companies Inc. | 205 | 2,000 |
| Share repurchases and cancellations through a normal course issuer bid | (2,139) | (12,264) |
| Outstanding as at December 31, 2001 | 40,669 | $ 232,237 |
| Issued as a result of options exercised | 58 | 294 |
| Share repurchases and cancellations through a normal course issuer bid | (593) | (3,346) |
| Outstanding as at December 31, 2002 | 40,134 | $ 229,185 |

In July 2001, the remaining installment of share consideration in respect of the acquisition of the Enterprise Group of Companies Inc. in 1998 was issued. No further amounts are payable in respect of this acquisition.

### (b) Stock-Based Compensation

Under the Company's Incentive Stock Option Plan, certain employees of the Company may be granted options to purchase, for cash, common shares at an exercise price of not less than 100% of the market value of the common shares at the date of grant. Generally, the options vest proportionately over either three or four years. Vesting is conditional upon pre-determined share price thresholds being achieved for the common shares for options granted prior to 2001. At December 31, 2002, the Company had authorized options to purchase 4,000,000 common shares (December 31, 2001 – 4,000,000 common shares) of which 1,640,292 (December 31, 2001 – 1,481,816) have yet to be granted. Option expiration dates range from fiscal 2003 to fiscal 2012.

A summary of the Company's common share options issued and cancelled is as follows:

| | NUMBER OF OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE PER SHARE |
|---|---|---|
| Outstanding as at January 31, 2001 | 937,500 | $ 8.45 |
| Granted during the period | 1,777,700 | 5.03 |
| Cancelled during the period | (197,016) | 5.04 |
| Outstanding as at December 31, 2001 | 2,518,184 | $ 6.30 |
| Granted during the year | 302,800 | 5.73 |
| Exercised during the year | (60,550) | 5.04 |
| Expired during the year | (400,000) | 10.00 |
| Cancelled during the year | (726) | 5.04 |
| Outstanding as at December 31, 2002 | 2,359,708 | $ 5.63 |

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

A summary of the Company's common share options outstanding as at December 31, 2002 is as follows:

| RANGE OF EXERCISE PRICE PER SHARE | NUMBER OF OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE PER SHARE | WEIGHTED AVERAGE REMAINING LIFE (YEARS) | NUMBER OF OPTIONS EXERCISABLE |
|---|---|---|---|---|
| $ 5.00 – 6.00 | 1,997,208 | $ 5.18 | 8.6 | 429,852 |
| $ 7.92 – 9.74 | 362,500 | 8.15 | 4.7 | 150,000 |
| | 2,359,708 | | | 579,852 |

On December 10, 2002, the Company granted 302,800 options with a strike price of $5.73, expiring in December 2012. The options vest over a four year period. The fair value of these options using the Black Scholes model as of the grant date was $507,000. This valuation assumes volatility of 30% and a risk free rate of 5.03%.

If the fair value of these options was recognized as an expense over the four year vesting period, the effect on net income for the year ended December 31, 2002 would have been as follows:

| | DOLLARS (THOUSANDS, EXCEPT PER SHARE AMOUNTS) |
|---|---|
| Net income as reported | $ 6,320 |
| Stock compensation expense | (7) |
| Pro forma net income | $ 6,313 |
| Pro forma net income per share | |
| Basic | $ 0.04 |
| Diluted | $ 0.04 |

Under the Company's Deferred Share Unit plan for employees, certain employees of the Company may be granted deferred share units ("DSU's") which vest on a date determined by the board of directors to be no later than the third anniversary of the date of grant and which will be exchanged for common shares of the Company issued from treasury or purchased in the market or paid in cash on the date of vesting, at the Company's option. At any given time, one DSU has a value equal to one common share.

Under the Company's Deferred Share Unit plan for directors, a portion of each outside director's annual retainer is paid in DSU's, which vest on the date of their retirement and which will be exchanged for common shares of the Company issued from treasury or purchased in the market or paid in cash on the date of vesting, at the Company's option.

At December 31, 2002, 119,834 DSU's (December 31, 2001 – 105,994 DSU's) having a total value of $660,000 (December 31, 2001 – $560,708) were outstanding, none of which vest until retirement of a board member in the case of directors' DSU's and all of which vest during 2003 in the case of employees' DSU's. Subsequent to year end, 82,710 employee DSU's were paid in cash, upon vesting, for a total of $462,000.

On June 27, 2001, O&Y REIT adopted a Unit Option Plan providing for the issuance, from time to time, at the discretion of the trustees, of options to purchase limited voting units of O&Y REIT for cash.

Participation in the Unit Option Plan is restricted to the trustees, the members of O&Y REIT's management and the officers and employees of OYPI and its affiliates so long as the Development Agreement, Leasing Management Agreement, Non-Competition Agreement, Property Management Agreement or Services Agreement entered into with OYPI is in effect. The Unit Option Plan complies with the requirements of the Toronto Stock Exchange. The exercise price of any option granted will not be less than the fair market value of the limited voting units on the date of grant. The options have a maximum term of ten years from the date of grant. The maximum number of limited voting units reserved for issuance pursuant to the Unit Option Plan is 2.5 million limited voting units.

One million options were granted during the period ended December 31, 2001 at an exercise price of $10.00 per limited voting unit. They expire in 2006. During the year ended December 31, 2002, 7,600 of these options were exercised. The remainder are outstanding as of December 31, 2002. One-third of these options vested on June 27, 2002 and one-third will vest on each of June 27, 2003 and 2004. No further option grants have taken place since December 31, 2001.

## 13. PER SHARE AMOUNTS

The following tables set forth the computation of per share amounts:

Basic and diluted earnings per share

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| (i) Basic earnings | | |
| Net income for the period | $ 6,320 | $ 10,239 |
| Accretion on equity component of convertible securities, net of tax | (4,850) | (4,457) |
| Net income and diluted net income available to common shareholders | $ 1,470 | $ 5,782 |
| (ii) Denominator | | |
| Weighted average shares outstanding for basic per share amounts | 40,456 | 42,014 |
| Unexercised options and deferred share units | 339 | 278 |
| Denominator for diluted net income available to common shareholders | 40,795 | 42,292 |
| Basic earnings per share | $ 0.04 | $ 0.14 |
| Diluted earnings per share | $ 0.04 | $ 0.14 |

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

Basic and diluted funds from operations per share

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| (i) Funds from operations | | |
| Funds from operations for the period | $ 55,798 | $ 45,359 |
| Imputed interest on liability component of convertible securities | 991 | 1,260 |
| Interest due on convertible securities | (6,826) | (6,722) |
| Funds from operations available to common shareholders | $ 49,963 | $ 39,897 |
| (ii) Diluted funds from operations | | |
| Funds from operations available to common shareholders | $ 49,963 | $ 39,897 |
| Interest due on convertible securities | 6,826 | 6,722 |
| Diluted funds from operations available to common shareholders | $ 56,789 | $ 46,619 |
| (iii) Denominator | | |
| Weighted average shares outstanding for basic per share amounts | 40,456 | 42,014 |
| Unexercised options and deferred share units | 339 | 278 |
| Convertible securities | 11,318 | 11,943 |
| Denominator for diluted funds from operations available to common shareholders | 52,113 | 54,235 |
| Basic funds from operations per share | $ 1.23 | $ 0.95 |
| Diluted funds from operations per share | $ 1.09 | $ 0.86 |

The following securities were not included in the diluted per share calculations as the effect would have been anti-dilutive:

| | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER OF SHARES IF CONVERTED OR EXERCISED (000s) DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|---|
| **EARNINGS PER SHARE** | | | |
| Common share options | $ 9.12 | — | 763 |
| Common share options | $ 7.62 | 463 | — |
| Convertible unsecured subordinated debentures | $ 11.50 | 7,924 | 8,348 |
| Series 1 convertible preferred shares and exchangeable notes, and Series A convertible debentures | $ 8.25 | 3,394 | 3,394 |
| **FUNDS FROM OPERATIONS PER SHARE** | | | |
| Common share options | $ 9.12 | — | 763 |
| Common share options | $ 7.62 | 463 | — |

## 14. LAND LEASES, GROUND RENT AND ENTITLEMENTS

### First Canadian Place

The land lease for FCP provides that the other land owner has an entitlement to certain payments to the extent cash is available from FCP. Payments from FCP's gross receipts under the land lease consist of eight levels, whereby the cash entitlements under each prior level must be met before payments are made with respect to the next level in any given year. Included in these financial statements as ground rent and entitlements expense in respect of the FCP land lease are amounts totalling $21,934,000 (eleven months ended December 31, 2001 – $19,968,000). Payments to the other land owners were $20,484,000 for the year ended December 31, 2002 (eleven months ended December 31, 2001 – $21,089,000). Remaining unpaid entitlements at the end of the year total $2,498,000 (December 31, 2001 – $1,048,000) and are included in accounts payable and accrued liabilities.

The land lease for FCP runs until 2023 or longer under certain circumstances. FCP is managed by OYPI. Under the land lease, the Company coordinates its efforts with the other land owner through a committee that oversees the performance of FCP. Half of the members of the committee are representatives of the Company and the balance are representatives of the other land owner. At the end of the lease the other land owner has the option to acquire a 50% interest in FCP for a nominal amount.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

The land lease provides that gross receipts of FCP are to be distributed in a specific order of priority. The order of priority for the annual entitlements is as follows:

(a) operating costs – annual property operating costs including capital expenditures, tenant allowances and leasing costs.

(b) amortization of the construction amount – an amount allocated to the Company calculated based on an annual blended payment of principal and interest on the construction amount. This amortized payment is recalculated each year using the Average Interest Rate ("AIR") and a period commencing on January 1 of the year of calculation and ending on December 31, 2023. The AIR fluctuates periodically and is based on a formula in the land lease. The AIR for the year ended December 31, 2002 was 5.46 % (eleven-month period ended December 31, 2001 – 6.8%). The balance of the construction amount at December 31, 2002 is $166,190,000 (December 31, 2001 – $170,380,000).

(c) ground rents – annual ground rents on a pari passu basis as to 50% to the other FCP land owner and a corresponding 50% payment to the Company. Ground rents are adjusted when the AIR is below 9%. Payments in respect of ground rent to the other FCP land owners during the year were $984,000 (eleven months ended December 31, 2001 – $1,089,000).

(d) amortization of additional amounts – an amount allocated to the Company calculated based on annual blended payments of principal and interest on funds advanced for certain cost overruns. The amortized payments are recalculated each year using the AIR + 1% and a period commencing on January 1 of the year of calculation and ending on December 31, 2023. The balance of the additional amounts at December 31, 2002 is $19,284,000 (December 31, 2001 – $19,714,000).

(e) recovery of additional funding – an amount allocated to the Company and the other FCP land owner on a pari passu basis representing their entitlements with respect to funds advanced to cover cash flow shortfalls resulting from deficiencies in prior years. All future annual gross receipts, after satisfaction of entitlements (a) to (d) above, will be allocated to satisfy the entitlements remaining under this level until the Company and the other FCP land owner are satisfied in full. The balance of any remaining entitlements will accrue interest at the AIR, compounded annually. The balance of the additional funding at December 31, 2002 is $9,548,000 (December 31, 2001 – $28,046,000) for each of the Company and the other FCP land owner.

(f) earnings participation – a fixed non-cumulative annual amount allocated to the other FCP land owner, of $887,500.

(g) recovery of the capital tax amount – an amount allocated to the Company representing Ontario capital tax computed upon an amount deemed to have been borrowed to finance the costs of construction of FCP. For this purpose, in each year, capital tax amounts are calculated based upon a notional amount of capital which decreases over the term of the land lease by the same percentage as the maximum capital cost allowance permitted under the Income Tax Act. All future annual gross receipts, after satisfaction of entitlements (a) to (f) above, will be allocated to satisfy the remaining capital tax entitlement of the Company until it is received in full and any remaining amounts will accrue interest at the AIR + 1% compounded annually. The cumulative capital tax entitlement amount at December 31, 2002 is $39,893,000 (December 31, 2001 – $37,304,000).

(h) remaining gross receipts – any remaining gross receipts will be allocated 50% to the Company and 50% to the other FCP land owner.

Changes during the period in entitlement balances are set out below:

| | OTHER FCP LAND OWNER | O&Y FPT INC. | YEAR ENDED DECEMBER 31, 2002 TOTAL | ELEVEN MONTHS ENDED DECEMBER 31, 2001 TOTAL |
|---|---|---|---|---|
| **UNAMORTIZED PRINCIPAL BALANCE OF CONSTRUCTION AMOUNT (b)** | | | | |
| Beginning of period | $ — | $ 170,380 | $ 170,380 | $ 173,447 |
| Interest | — | 8,976 | 8,976 | 10,405 |
| Repayments | — | (13,166) | (13,166) | (13,472) |
| End of period | $ — | $ 166,190 | $ 166,190 | $ 170,380 |
| **UNAMORTIZED PRINCIPAL BALANCE OF ADDITIONAL AMOUNTS (d)** | | | | |
| Beginning of period | $ — | $ 19,714 | $ 19,714 | $ 20,025 |
| Interest | — | 1,225 | 1,225 | 1,373 |
| Repayments | — | (1,655) | (1,655) | (1,684) |
| End of period | $ — | $ 19,284 | $ 19,284 | $ 19,714 |
| **ADDITIONAL FUNDING (e)** | | | | |
| Beginning of period | $ 28,046 | $ 28,046 | $ 56,092 | $ 91,706 |
| Interest | 1,002 | 1,002 | 2,004 | 4,386 |
| Repayments | (19,500) | (19,500) | (39,000) | (40,000) |
| End of period | $ 9,548 | $ 9,548 | $ 19,096 | $ 56,092 |
| **ACCUMULATED CAPITAL TAX AMOUNT (g)** | | | | |
| Beginning of period | $ — | $ 37,304 | $ 37,304 | $ 34,660 |
| Interest | — | 2,415 | 2,415 | 2,476 |
| Capital tax | — | 174 | 174 | 168 |
| End of period | $ — | $ 39,893 | $ 39,893 | $ 37,304 |

If all the outstanding entitlements in respect of levels (b), (d), (e) and (g) above have been recovered as of December 31, 2023, the land lease will expire and the other FCP land owner will have the option to acquire, for a nominal amount, an undivided 50% beneficial interest in the office tower, retail complex and the podium. If, however, there are amounts still to be recovered, the land lease may be extended for a maximum of 50 years until all such amounts have been paid.

The AIR used in the calculation of the annual amortization at levels (b) and (d), the amount at level (c) and the remaining balances at levels (e) and (g) is calculated in accordance with the terms of the land lease and has been fixed for the three years ending December 31, 2004 at 5.46%.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

O&Y REIT

O&Y REIT has obligations under long-term leases for land as follows:

Place de Ville I, a rental property in Ottawa, is on land leased from a major life insurance company until the year 2065. Annual land rental payments are $1.455 million until March 2006 and $2.1 million from April 2006 to March 2016. For the periods April 2016 to March 2041 and April 2041 to March 2065, the annual rental payment will be equal to 6 5/8% of the fair market value of the land on March 31, 2015 and March 31, 2040 respectively.

18 King Street East, a rental property in Toronto, is on land leased from a private company until the year 2067. The rental payment is contracted at fixed levels for the next 16 years. The rent, which has been set at $560,000 for 2003 escalates by approximately $10,000 per year until 2010 when it reaches $650,000, where it remains until 2013. From 2014 to 2018, the annual rental payment increases to $660,000 per year. For the 25 years beginning December 1, 2018, the annual rental payment will be equal to 6 1/2% of the fair market value of the land at the beginning of the period plus 2% of the gross annual income from the property for each year. In no event will the annual rental payment be less than the average rent for the immediately preceding 25 year period. For the 24 years beginning December 1, 2043, the annual rental payment will be calculated in the same manner as during the immediately preceding 25 year period.

Minimum lease payments for the next 5 years are summarized as follows:

| | | |
|---|---|---|
| 2003 | $ | 2,015 |
| 2004 | $ | 2,025 |
| 2005 | $ | 2,035 |
| 2006 | $ | 2,583 |
| 2007 | $ | 2,750 |

Payments under these land leases totalled $2,005,000 in the year ended December 31, 2002 and $1,843,000 in the eleven months ended December 31, 2001.

Other

The Maritime Life Tower at 2 Queen Street East, Toronto is located on land which is partially leased from a third party until 2099. The annual payments are $295,000, adjusted every 10 years commencing in 2013 for changes in the Consumer Price Index. The Company has an option, exercisable every 10 years commencing in 2023, to purchase the leased land at a price equal to the then current annual rent, capitalized at 8%. The payments under this lease are capitalized to the property under development until the development period ends.

## 15. OTHER ITEMS

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| Gains (losses) due to: | | |
| (a) Loss on repurchase of convertible unsecured subordinated debentures | $ (1,084) | $ (685) |
| (b) Gain on repurchase of unsecured debentures of a subsidiary | 259 | — |
| (c) Gain on disposition of rental properties, net | — | 1,770 |
| (d) Restructuring charge | (6,976) | (4,450) |
| Total other items | $ (7,801) | $ (3,365) |
| Current tax benefit (expense) due to: | | |
| Loss on repurchase of convertible unsecured subordinated debentures | 417 | 240 |
| Gain on repurchase of debentures of a subsidiary | (101) | — |
| Gain on disposition of rental properties | — | (12,125) |
| Restructuring charge | 2,983 | 265 |
| Adjustment to capital gains reserve | 2,298 | — |
| Total current tax benefit (expense) on other items | 5,597 | (11,620) |
| Non-operating items, net | $ (2,204) | $ (14,985) |

(a) Repurchase of Convertible Unsecured Subordinated Debentures

During the year ended December 31, 2002, par value of $5.3 million of convertible subordinate debentures were repurchased for $4.4 million and cancelled. Details of the transactions are set out below.

| *Year ended December 31, 2002* | LIABILITY COMPONENT | EQUITY COMPONENT | TOTAL |
|---|---|---|---|
| Net book value of the debentures repurchased | $ 389 | $ 5,033 | $ 5,422 |
| Purchase price | 1,473 | 2,961 | 4,434 |
| Gain (loss), before current income taxes | (1,084) | 2,072 | 988 |
| Current income tax recovery (expense) | 417 | (800) | (383) |
| Gain (loss), net of current income taxes | $ (667) | $ 1,272 | $ 605 |

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

During the eleven-month period ended December 31, 2001, par value of $4.0 million of the convertible unsecured subordinated debentures were repurchased for $3.1 million and cancelled. Details of the transactions are set out below.

| *Eleven Months ended December 31, 2001* | LIABILITY COMPONENT | EQUITY COMPONENT | TOTAL |
|---|---|---|---|
| Net book value of the debentures repurchased | $ 439 | $ 3,664 | $ 4,103 |
| Purchase price | 1,124 | 1,991 | 3,115 |
| Gain (loss), before current income taxes | (685) | 1,673 | 988 |
| Current income tax recovery (expense) | 240 | (586) | (346) |
| Gain (loss), net of current income taxes | $ (445) | $ 1,087 | $ 642 |

As the debentures are segregated into debt and equity components on the balance sheet, the purchase price was allocated to the components at the date of repurchase. The allocation of the purchase price was determined by a measure of the respective fair values of the components at the date of repurchase. The net loss on the liability component resulted in a charge to net income. The net gain on the equity component resulted in an increase in contributed surplus.

### (b) Repurchase of Unsecured Debentures of a Subsidiary

During the year ended December 31, 2002 the Company repurchased unsecured debentures of a subsidiary, resulting in pre-tax gain of $259,000 and an after tax gain of $158,000.

### (c) Disposition of Rental Properties

On June 7, 2001, the Board of Directors approved the transfer, by a subsidiary of the Company, of certain rental properties to O&Y REIT in connection with O&Y REIT's initial public offering. The transaction closed on June 27, 2001. The total sale price of $506 million for the office portfolio resulted in an accounting gain of $1.8 million before income taxes and cash income taxes payable of approximately $27 million. The Company retired debt, not assumed by O&Y REIT, and incurred debt retirement costs totaling $43 million.

As a result of the transaction, the Company owned 50.11% of O&Y REIT and therefore consolidates its financial results with those of O&Y REIT. Interest of others in O&Y REIT of $164.9 million (December 31, 2001 – $144.1 million), as shown in the consolidated balance sheets, represents the interests of O&Y REIT unitholders other than O&Y Properties Corporation. In calculating consolidated net income, a deduction is made to reflect the portion of O&Y REIT's net income attributable to the interest of others in O&Y REIT.

### (d) Restructuring Charge

A restructuring provision of $7 million was recorded in the year ended December 31, 2002 (eleven months ended December 31, 2001 – $4.5 million) consisting primarily of employee severance costs relating to the Real Estates Services Business.

## 16. SEGMENTED INFORMATION

The Company's operating segments comprise the ownership of rental properties and the provision of real estate services, primarily to third-party commercial property owners.

| *Year ended December 31, 2002* | RENTAL PROPERTIES HELD BY O&Y REIT | FIRST CANADIAN PLACE | REAL ESTATE SERVICES | OTHER | INTER SEGMENT | TOTAL |
|---|---|---|---|---|---|---|
| Real estate assets | $ 572,156 | $ 511,494 | $ — | $ 119,088 | $ (22,928) | $ 1,179,810 |
| Other assets | 108,555 | 17,691 | 36,304 | 6,941 | (89,498) | 79,993 |
| Secured debt | 239,709 | 284,428 | — | 51,027 | — | 575,164 |
| Capital expenditures and tenant inducements | 9,281 | 5,377 | 5,425 | 53,589 | (431) | 73,241 |
| Operating revenues | $ 109,292 | $ 132,830 | $ 60,799 | $ (1,249) | $ (9,937) | $ 291,735 |
| Operating expenses | 50,790 | 68,319 | 51,841 | 20 | (8,875) | 162,095 |
| Ground rent and entitlements | 2,005 | 21,934 | — | — | — | 23,939 |
| Rental and real estate services income | 56,497 | 42,577 | 8,958 | (1,269) | (1,062) | 105,701 |
| Depreciation and amortization | 8,829 | 12,319 | 3,762 | 2,334 | — | 27,244 |
| Operating income (loss) | $ 47,668 | $ 30,258 | $ 5,196 | $ (3,603) | $ (1,062) | $ 78,457 |

| *Eleven Months ended December 31, 2001* | RENTAL PROPERTIES HELD BY O&Y REIT | FIRST CANADIAN PLACE | REAL ESTATE SERVICES | OTHER | INTER SEGMENT | TOTAL |
|---|---|---|---|---|---|---|
| Real estate assets | $ 508,941 | $ 521,021 | $ — | $ 67,703 | $ (21,654) | $ 1,076,011 |
| Other assets | 101,325 | 12,300 | 42,856 | 2,759 | (86,746) | 72,494 |
| Secured debt | 227,447 | 290,038 | — | 7,780 | — | 525,265 |
| Capital expenditures and tenant inducements | 11,100 | 3,427 | 3,349 | 22,164 | — | 40,040 |
| Operating revenues | $ 91,565 | $ 118,694 | $ 63,209 | $ 1,281 | $ (9,481) | $ 265,268 |
| Operating expenses | 41,703 | 60,088 | 55,511 | 2,562 | (9,171) | 150,693 |
| Ground rent and entitlements | 1,843 | 19,968 | — | — | — | 21,811 |
| Rental and real estate services income | 48,019 | 38,638 | 7,698 | (1,281) | (310) | 92,764 |
| Depreciation and amortization | 8,530 | 11,313 | 8,720 | 1,430 | — | 29,993 |
| Operating income (loss) | $ 39,489 | $ 27,325 | $ (1,022) | $ (2,711) | $ (310) | $ 62,771 |

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

Operating income comprises net income excluding financing expense, corporate expense, system implementation costs, other items, interest of others in O&Y REIT and income tax expense. Other assets exclude cash, cash equivalents and short-term investments. Real estate assets include rental properties, properties under development and land held for development.

Revenues from the Federal Government under various leases exceed 10% of the Company's total revenues and represent approximately $43 million of revenues in the rental properties held by O&Y REIT (eleven months ended December 31, 2001 – $40 million).

## 17. JOINT VENTURES

The consolidated financial statements include the Company's proportionate interest in its activities conducted jointly with other parties as follows:

| | YEAR ENDED DECEMBER 31, 2002 | ELEVEN MONTHS ENDED DECEMBER 31, 2001 |
|---|---|---|
| Assets | $ 76,032 | $ 87,199 |
| Liabilities | 41,258 | 47,613 |
| Revenues | 22,440 | 11,526 |
| Expenses | 18,398 | 8,383 |
| Net income | 4,042 | 3,143 |
| Cash provided by operating activities | 4,429 | 3,619 |
| Cash used in financing activities | 888 | 517 |
| Cash used in investing activities | 7,795 | 2,014 |

The Company is contingently liable for certain of the joint venture obligations of its co-venturers in the joint ventures. The assets of each of the joint ventures are sufficient for the purpose of satisfying such obligations.

## 18. COMMITMENTS AND CONTINGENCIES

The Company has obligations as lessee under long-term leases for land and equipment which are described in notes 14 and 9 respectively.

The cost to complete the property under development is approximately $10 million.

The Company is involved in litigation and claims which arise from time to time in the normal course of business. In the opinion of management, none of these, individually or in aggregate, would result in a liability that would have a significant adverse effect on the financial position of the Company.

## 19. FINANCIAL INSTRUMENTS

In the normal course of its business the Company is exposed to a number of financial risks that can affect its operating performance. These risks, and the actions taken to manage them, are as noted below. The Company does not have foreign exchange risk as it holds only Canadian dollar denominated assets and liabilities. At December 31, 2002, the Company has no contracts involving derivative financial instruments.

### (a) Interest Rate Risk

A portion of the Company's debt is at floating rates and, as a result, the Company is exposed to changes in interest rates. Increases or decreases in these rates would decrease or increase the Company's earnings. As part of its risk management program, the Company endeavours to maintain an appropriate mix of fixed rate and floating rate debt with staggered maturities and strives to match the nature and timing of lease inflows to financings thereon.

### (b) Credit Risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The Company's credit risk is limited to the recorded amount of tenant receivables. Anticipated bad debt loss has been provided for in the allowance for doubtful accounts.

*(all tabular amounts stated in thousands of dollars unless otherwise noted)*

(c) Fair Value

The fair value of the Company's financial assets and liabilities, representing net working capital, approximate their recorded values at December 31, 2002.

The fair value of the Company's debentures, notes and preferred shares is approximately $107 million (December 31, 2001 – $105 million). The fair value of the Company's secured debt at prevailing market interest rates is $615 million (December 31, 2001 – $544 million). The fair values have been estimated based on the current market rates for financial instruments with similar terms and conditions.

## 20. RELATED PARTY TRANSACTION

On July 9, 2002, the Company loaned $150,000 to the Chairman of the Board of Directors of the Company at an interest rate of 5% per annum. The loan was repaid on December 31, 2002.

## 21. COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified to conform with the presentation for the current period.

## 22. SUBSEQUENT EVENT

On April 1, 2003 O&Y REIT agreed to purchase the remaining 50% interest in each of the Canadian Western Bank Building and Enbridge Tower, both located in Edmonton, Alberta, from its unrelated co-owners. The total purchase price for the remaining 50% interest in the two buildings is $23.25 million. The transactions are expected to close in May 2003.

The acquisitions are being financed through the assumption of the vendors' share of the mortgages, amounting to $12.3 million, with the balance to be funded through O&Y REIT's operating/acquisition facility. The mortgages to be assumed carry a weighted average interest rate of 6.58%.

# CORPORATE DIRECTORY AND INVESTOR INFORMATION

## DIRECTORS

Ronald Appleby, Q.C.
Senior Partner
Robins, Appleby & Taub
Toronto, Ontario

Austin C. Beutel
President
Oakwest Corporation Limited
Toronto, Ontario

Tibor Donath
Partner
Bench & Donath
Toronto, Ontario

Abraham Fruchthandler
General Partner
FBE Limited
New York, New York

Stanley H. Hartt, O.C., Q.C.
Chairman
Citigroup Global Markets Canada Inc.
Toronto, Ontario

Frank Hauer
President
O&Y Properties Corporation
Toronto, Ontario

The Honourable Marc Lalonde, P.C., O.C., Q.C.
Senior Partner
Stikeman, Elliot
Montreal, Quebec

Samuel W. Linhart, FCA
Chairman and CEO
Merit Properties Group, L.L.C.
Paradise Valley, Arizona

Philip Reichmann
Chief Executive Officer
O&Y Properties Corporation
Toronto, Ontario

Maureen Sabia
President
Maureen Sabia International
Toronto, Ontario

Albert Schonkopf
President
Crown Group of Companies
New York, New York

Walter Zwig
Corporate Director
Toronto, Ontario

## CORPORATE OFFICERS

Stanley H. Hartt, O.C., Q.C.
Chairman of the Board

Philip Reichmann
Chief Executive Officer

Frank Hauer
President

Raghunath Davloor
Chief Financial Officer

Geoff Harrison
President, O&Y Enterprise

John Levitt
Senior Vice President,
Business Development

Randy Northey
Senior Vice President,
General Counsel and Secretary

Jan Sucharda
Senior Vice President,
Asset Management

Brian Wilson
Senior Vice President,
Finance & Administration

Floriana Cipollone
Vice President,
Corporate Planning & Strategy

Maria Rico
Vice President, Finance

## STOCK EXCHANGE LISTING

Toronto Stock Exchange (TSX)

## STOCK TRADING SYMBOL

Common Shares: OYP
Convertible Debentures: OYP.DB

## INVESTOR RELATIONS

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e-mail: ir@oyp.com
Web site: www.oyp.com

## SHARE TRANSFER AGENT AND REGISTRAR

(for change of address, registration
or other shareholder enquiries)
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Toll free throughout North America:
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e-mail: inquiries@cibcmellon.ca

## AUDITORS

Deloitte & Touche LLP
Chartered Accountants
Toronto, Ontario

## ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Shareholders of O&Y Properties Corporation will be held at 2:00 p.m. Toronto time on Wednesday, June 25, 2003, at the TSX Auditorium, The Exchange Tower, 130 King Street West, Toronto, Ontario, Canada

# CORPORATE OFFICES


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Fax: (780) 421-0895

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Fax: (613) 563-9694

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B3J 3N2
Telephone: (902) 425-2930
Fax: (902) 425-2736

# PROPERTY PORTFOLIO

# PROPERTY PORTFOLIO

*(as of March 31, 2003)*

| PROPERTY | DESCRIPTION | DATE DEVELOPED/ RENOVATED | OFFICE AREA (SQ. FT.) | RETAIL AREA (SQ. FT.) | STORAGE & ARCHIVAL AREA (SQ. FT.) | TOTAL GLA (SQ. FT.) | INTEREST OWNED BY O&Y REIT (%) | INTEREST OWNED BY O&Y REIT GLA (SQ. FT.) |
|---|---|---|---|---|---|---|---|---|
| **HALIFAX** | | | | | | | | |
| Purdy's Wharf | 18- and 22-storey office towers and 4-storey office/retail building; 7-storey parking deck for 1,084 vehicles | 1985, 1989 | 685,000 | 10,000 | — | 695,000 | 50 | 347,500 |
| **OTTAWA** | | | | | | | | |
| Place de Ville I | Two 22-storey office towers; underground parking for 974 vehicles | 1967/1999 | 550,000 | 38,500 | 29,000 | 617,500 | 100 | 617,500 |
| Place de Ville II | 29-storey office tower, 4-storey office building; underground parking for 770 vehicles | 1972/1995 | 577,000 | 57,000 | 33,000 | 667,000 | 100 | 667,000 |
| Jean Edmonds Towers | Two 20-storey office towers; surface parking for 34 vehicles | 1973/1995 | 531,000 | 21,000 | 96,000 | 648,000 | 100 | 648,000 |
| **TORONTO** | | | | | | | | |
| 18 King St. East | 17-storey office tower; underground parking for 70 vehicles | 1967/1999 | 218,000 | 10,000 | 5,000 | 233,000 | 100 | 233,000 |
| 2/24 St. Clair Ave. West | 21-storey office tower; surface and underground parking for 161 vehicles | 1965/1999 | 210,000 | 20,000 | 8,000 | 238,000 | 100 | 238,000 |
| 40 St. Clair Ave. West | 13-storey office tower; surface and underground parking for 94 vehicles | 1966/1989 | 118,000 | 4,000 | 5,000 | 127,000 | 100 | 127,000 |
| **NIAGARA FALLS** | | | | | | | | |
| Acres House | 6-storey office building; surface and underground parking for 238 vehicles | 1995 | 138,000 | 3,000 | 8,500 | 149,500 | 100 | 149,500 |
| **WINNIPEG** | | | | | | | | |
| 330 St. Mary Avenue | 12-storey office tower; underground and surface parking for 89 vehicles | 1980 | 145,000 | 5,000 | — | 150,000 | 100 | 150,000 |
| 75 Hargrave Street | 7-storey office building; surface parking available for 13 vehicles, access to an additional 35 parking stalls | 1975 | 69,000 | 2,000 | — | 71,000 | 100 | 71,000 |
| **CALGARY** | | | | | | | | |
| Altius Centre | 31-storey office tower; adjoining parkade for 287 vehicles | 1974/1996 | 297,000 | 8,000 | — | 305,000 | 100 | 305,000 |
| 40 – 7th Ave. S.W. | 20-storey office tower, underground parking for 112 vehicles, access to an additional 61 parking stalls | 1979/2000 | 246,000 | 12,000 | 4,500 | 262,500 | 100 | 262,500 |
| McFarlane Tower | 18-storey office tower and adjoining 3-storey building; underground parking for 156 vehicles | 1979/2000 | 193,000 | 48,000[1] | 2,000 | 243,000 | 100 | 243,000 |
| 035 – 7th Ave. S.W. | 6-storey office building; surface and underground parking for 58 vehicles, access to an additional 49 parking stalls | 1979/2002 | 76,500 | — | — | 76,500 | 100 | 76,500 |
| Mount Royal Place | 6-storey office building; surface and underground parking for 98 vehicles | 1979 | 52,000 | 4,000 | — | 56,000 | 100 | 56,000 |
| Franklin Atrium | Twin atrium 2-storey office buildings; surface parking for 398 vehicles | 1981 | 142,000 | — | 2,000 | 144,000 | 100 | 144,000 |
| Franklin Building | 2-storey office building; parking for 156 vehicles | 1978 | 51,000 | — | — | 51,000 | 100 | 51,000 |
| **EDMONTON** | | | | | | | | |
| Canadian Western Bank Building | 30-storey office tower; parking garage for 357 vehicles | 1981/2000 | 352,000 | 52,000[2] | 4,000 | 408,000 | 50 | 204,000 |
| Enbridge Tower | 20-storey office tower; underground parking for 106 vehicles | 1980 | 178,000 | 4,000 | 5,000 | 187,000 | 50 | 93,500 |
| **SUB TOTAL** | | | 4,828,500 | 298,500 | 202,000 | 5,329,000 | | 4,684,000 |
| | | | | | | | INTEREST OWNED DIRECTLY | |
| **TORONTO** | | | | | | | | |
| First Canadian Place | 72-storey mixed use office/retail complex | 1975/2000 | 2,386,000 | 238,000 | 52,000 | 2,676,000 | 100 | 2,676,000 |
| Maritime Life Tower | 20-storey office tower; underground parking for 174 vehicles | 2003 | 425,000 | 16,000 | 10,000 | 451,000 | 100 | 451,000 |
| **TOTAL** | | | 7,639,500 | 552,500 | 264,000 | 8,456,000 | | 7,811,000 |

Notes: [1]Includes a 45,200 square foot special use 3-storey building

[2]Includes a 22,500 square foot fitness club and 12,500 square feet of special use space

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## PROPERTY PORTFOLIO

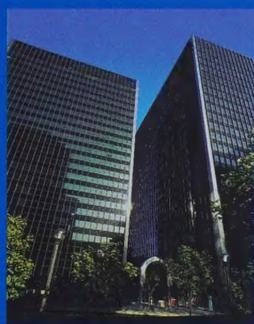
### O&Y PROPERTIES CORPORATION

First Canadian Place,
Toronto

Maritime Life Tower,
Toronto

### O&Y REAL ESTATE INVESTMENT TRUST

Purdy's Wharf,
Halifax



Place de Ville I,
Ottawa

Place de Ville II,
Ottawa

Jean Edmonds Towers,
Ottawa

18 King St. East,
Toronto

2/24 St. Clair Ave. West,
Toronto

40 St. Clair Ave. West,
Toronto


Acres House,
Niagara Falls

330 St. Mary Avenue,
Winnipeg

175 Hargrave Street,
Winnipeg

Altius Centre,
Calgary

840 – 7th Ave. S.W.,
Calgary

McFarlane Tower,
Calgary

1035 – 7th Ave. S.W.,
Calgary

Mount Royal Place,
Calgary

Franklin Atrium,
Calgary


Franklin Building,
Calgary

Canadian Western
Bank Building,
Edmonton

Enbridge Tower,
Edmonton

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